PHILLIPS PETROLEUM COMPANY • ANNUAL REPORT 1988

AR27

OPERATIONS THAT FIT TOGETHER TO BUILD STOCKHOLDER VALUE

Phillips Petroleum Company In Brief

Phillips is headquartered in Bartlesville, Okla., where the company was founded in 1917. Bartlesville is located in northeastern Oklahoma, about 50 miles from Tulsa.

Phillips is engaged in these businesses:

- Petroleum exploration and production on a worldwide scale.
- Petroleum refining and marketing in the United States.
- Chemicals production and distribution worldwide.

Company activities are organized into the following groups, whose operations are discussed in this report:

- Upstream Operations, which include Exploration & Production as well as Gas & Gas Liquids.
- Downstream Operations, which include Petroleum Products (refining, marketing and transportation) and Chemicals.

At year-end 1988, Phillips employed 21,000 people, had 96,922 stockholders and assets of $12 billion. The company's patented products and processes were used in 57 countries.

Corporate Profile

The Cover:

Operations That Fit Together to Build Stockholder Value

This year's cover celebrates Phillips integrated businesses. Being integrated as a petroleum company means producing raw materials and upgrading them into gasoline, chemicals, plastics and other products of greater value. Each face of the hexagon shown on the cover and to the right represents an aspect of Phillips integrated businesses —truly operations that fit together to build stockholder value.

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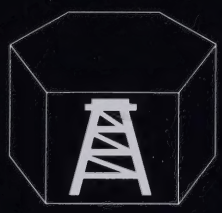
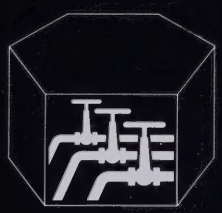
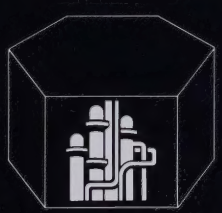


Exploration & Production. Where integration gets its start, Phillips exploration and production operations in 1988 produced some 81 million barrels of crude oil, or 222,000 barrels a day. Most of this oil goes to, or is traded for other oil that goes to, Phillips own refineries. There, it is processed into gasoline and other petroleum products. E&P is also responsible for producing natural gas.



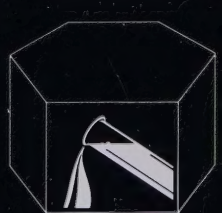
Gas & Gas Liquids. A hydrocarbon clearinghouse, this business gathers natural gas and extracts the gas liquids later used in Phillips downstream operations. Residue (dry) gas is sold or used as fuel by company facilities. Gas liquids are sent to Phillips refineries and chemical plants as a low-cost feedstock for production of gasoline, petrochemicals and plastics.



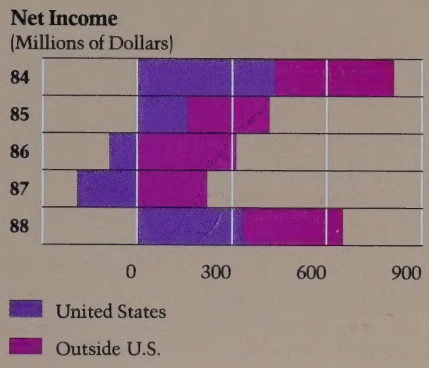
Refining. Another link in the integrated chain, Phillips refineries upgrade crude oil and natural gas liquids into gasoline and other products of higher value. Phillips operates some of the most advanced refineries in the industry—and ran them at peak capacity in 1988 for a third straight year.

Marketing. The face of Phillips best-known to customers, the company's marketing operations comprise 11,000 outlets in 28 states. Phillips in recent years has burnished its brand image by championing strict appearance standards for all stations bearing the Phillips 66 shield and building a number of company-operated stations.

Chemicals. A further step in integration, Phillips chemicals business upgrades lower-cost feedstock into petrochemicals, plastics and other products of greater value. Chemicals relies on a light hydrocarbon chain that starts with gas liquids and ultimately yields plastics.



Technology. It's the catalyst that helps Phillips transform raw materials and good ideas into profitable products and processes. Many of the company's best-known products—Marlex plastics, for instance—came from Phillips own labs. Phillips leads the industry in U.S. patents owned and earns licensing revenue from its products and processes.



Highlights

	Millions of Dollars Except as Indicated		
	1988	1987	1986
Financial			
Total revenues	**$11,490**	10,917	10,018
Net income	**$ 650**	35	228
Net income from each dollar of revenue	**5.7¢**	.3	2.3
Net income per share of common stock	**$ 2.72**	.06	.89
Interest expense	**$ 688**	729	685
Total taxes charged to income	**$ 675**	448	656
Capital expenditures	**$ 797**	737	646
Total assets at year-end	**$11,968**	12,111	12,403
Dividends paid			
Common	**$ 157**	137	159
Preferred	**$ 11**	19	24
Cash dividends per share			
Common	**$ .66**	.60	.70
Preferred	**$ 1.34**	1.73	2.02
Average common shares outstanding (in thousands)	**234,984**	228,326	227,546
	Thousands of Barrels Daily		
Operating			
Crude oil produced			
United States	**110**	113	124
Outside United States	**112**	105	114
Natural gas liquids produced	**186**	182	202
Total liquids produced	**408**	400	440
Crude oil refined	**301**	302	301
Petroleum products sold	**585**	555	554
	Millions of Cubic Feet Daily		
Natural gas produced	**1,189**	1,086	1,120
	Millions of Pounds		
Ethylene sales	**720**	903	803
Polyethylene sales	**1,585**	1,606	1,410

"Phillips," "the company," "we" and "our" are used interchangeably in this report to refer to the business of Phillips Petroleum Company and its consolidated subsidiaries. Where reference is made to a particular company, it is wholly owned unless otherwise stated. The company's consolidation policy is to include in financial statements the accounts of majority-owned, significant subsidiaries. Aspect, Crystalor, Driscopipe, K-Resin, Marlex, Phillips 66, Ryton and SuperClean are trademarks for the company's products named in this report.

C. J. Silas
Glenn A. Cox

To Our Fellow Shareholders:

Phillips had an excellent year in 1988, demonstrating the benefit of well-integrated operations in today's petroleum business.

During the year:

- We experienced better than an eighteenfold increase in earnings.
- We had another record year in chemicals and an outstanding year in petroleum refining and marketing.
- We increased the profit of our exploration and production group despite a decline in oil prices.
- We greatly surpassed our debt reduction goals and regained an investment-grade rating for our bonds.
- We took further steps to streamline operations and hold down costs.
- And we made a significant improvement in the value of your investment in the company, which is our number one objective.

Phillips net income for 1988 was $650 million, or $2.72 a share, compared with earnings of $35 million, or 6 cents a share, in 1987. This sharp improvement was largely the result of extraordinary performance by our downstream businesses—petroleum products, chemicals and plastics.

Higher Margins Downstream

In Chemicals, strong demand for core products—in particular, ethylene and polyethylene—helped support substantial price increases while raw material costs remained relatively stable. As a result, profit margins widened and operating earnings from this segment increased 89 percent over the previous year.

Increased demand also aided our petroleum products business, enabling us to continue running our refineries at full capacity. We also increased our share of the U.S. motor fuel market for the fifth straight year and increased sales of branded gasoline and higher-octane gasoline. Operating earnings from this business more than doubled over 1987.

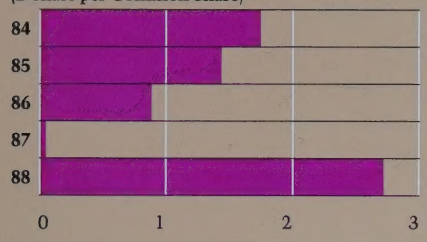
The environment was much different for our upstream businesses, those responsible for finding and producing oil and natural gas and for extracting the liquids from natural gas. During 1988, Phillips average worldwide crude oil sales price dropped by nearly $3 a barrel. Yet thanks to higher oil and gas production, higher U.S. gas prices and lower expenses, we achieved a 29 percent increase in upstream operating earnings. In addition, Phillips replaced 142 percent of the energy it produced during the year on a barrel-of-oil-equivalent basis.

Debt Reduction Accelerated

Because of strong earnings and cash flow, we were able to step up our debt reduction plans and reduce related interest costs. Total debt plus preferred stock declined by more than $900 million in 1988, while stockholders' equity grew by nearly $500 million, or 31 percent. As a result of our strengthening financial condition, we have regained our investment-grade bond ratings, an action that will allow any future refinancing of our debt on more favorable terms.

We carried out an $856 million capital spending and investment program in 1988 and have increased the budget to $975 million in 1989. Most of the increase will be devoted to capacity expansions in chemicals and plastics, areas where we have a strong competitive position. Upstream spending will remain focused on near-term development opportunities and exploration in lower-risk mature producing areas, both domestic

Net Income Per Share
(Dollars per Common Share)



Profit From Each Dollar of Revenue
(Cents per Dollar)

and foreign. At the same time, we will continue expanding our exploration efforts to selected frontier and international areas that have potential for major discoveries.

We're proud that during 1988 our common stock's total return to shareholders—share price appreciation plus dividends—was 44 percent. We've raised the quarterly dividend rate twice since we last reported to you, for a cumulative increase of 47 percent. And we remain committed to a competitive return on our shareholders' investment.

Mission of Value

This objective, long implicit in our actions, has been incorporated into a statement defining our mission as "To enhance the value of our shareholders' investment by using the strengths of our people and our integrated operations to provide our customers with products that are high in quality and competitive in price."

Looking ahead, we expect oil prices to stay in the range of $15 to $20 a barrel for some time and are planning our investments accordingly. In our upstream businesses, we will keep working to restrain costs and improve technology, while keeping production and reserves as high as possible.

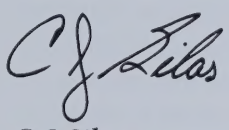
Downstream, we will be challenged to achieve profit margins as high in 1989 as in 1988. This is because raw material costs seem to be strengthening as the prices of finished products are leveling off. However, we expect a generally favorable business climate to continue and see sound investment opportunities in several downstream business lines. As an example, we're expanding production of both ethylene, a basic chemical used in many products, and polyethylene, a popular plastic.

Veteran Board Member Dies

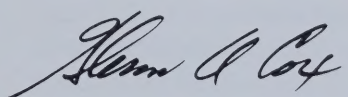
We were saddened by the death this January of David B. Meeker, a longtime member of our board of directors. David brought to our board the strong business experience of a corporate chief executive and an independent point of view. We will miss his counsel and graciousness but will remember his dedication to our shareholders.

No question, 1988 was a pivotal year for our company. We gained financial momentum that will be of benefit for years to come. And we did so at a time when the price of our principal commodity, crude oil, showed further signs of weakness. We pledge to continue managing Phillips assets wisely in this environment, and we appreciate your support.

For the Board of Directors,



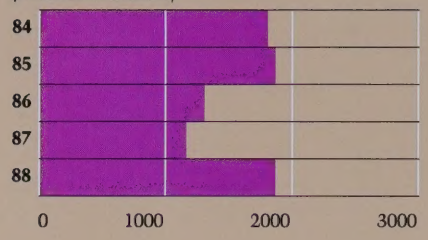
C. J. Silas
Chairman & Chief Executive Officer



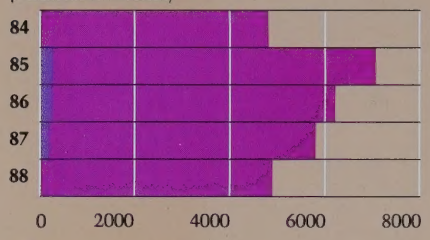
Glenn A. Cox
President & Chief Operating Officer

March 10, 1989

Cash Flow From Operations
(Millions of Dollars)

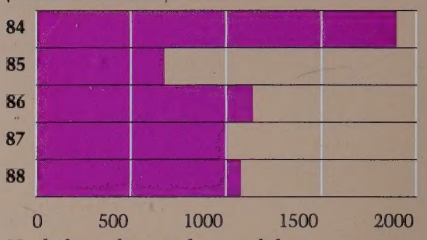


Total Debt and Preferred Stock Balances at Year-End
(Millions of Dollars)



Preferred Stock
Total Debt

Cash Balances at Year-End*
(Millions of Dollars)



**Includes cash equivalents and short-term investments.*

Financial Summary

Phillips made major strides strengthening its financial condition in 1988. Total debt and preferred stock fell by more than $900 million, while stockholders' equity grew by nearly $500 million. The company also refinanced debt in 1988, thus reducing related interest expense and the amount of principal due in certain future years.

Top Objectives: Boosting Value, Reducing Debt

Increase Shareholder Value. Phillips is committed to providing shareholders with a competitive return on their investment. In 1988, the company's common stock total return—share price appreciation plus dividends—was 44 percent, the highest of any major oil company and far greater than the stock market in general. Phillips increased its quarterly common share dividend from 15 to 18 cents a share in July 1988, and to 22 cents a share in January 1989.

Reduce Debt to $4.0-$4.5 Billion. Thanks to an accelerated debt reduction program, Phillips total debt will reach the upper part of this range early in 1989. Such a level of debt is roughly half of the 1985 peak.

Build Equity Base to $3.0 Billion. Primarily through higher earnings, Phillips hopes to reach this goal by the early 1990s. Higher equity would contribute to financial flexibility and further improve the company's debt ratios. Phillips common stockholders' equity grew by $496 million, or 31 percent, during 1988, even after higher dividend payments.

Improve Credit Ratings. During 1988 and early 1989, Phillips reached a key objective of regaining investment-grade ratings for its debt, a status lost when oil prices collapsed in 1986. Investment-grade ratings are important in the company's view because they allow greater flexibility for future borrowing or refinancing.

Earnings/Cash Flow: Strong Momentum

Earnings showed strong improvement during 1988, a result of record downstream performance and moves to improve efficiency and control costs. Cash flow from operations was $1.87 billion, an increase of $703 million, or 60 percent.

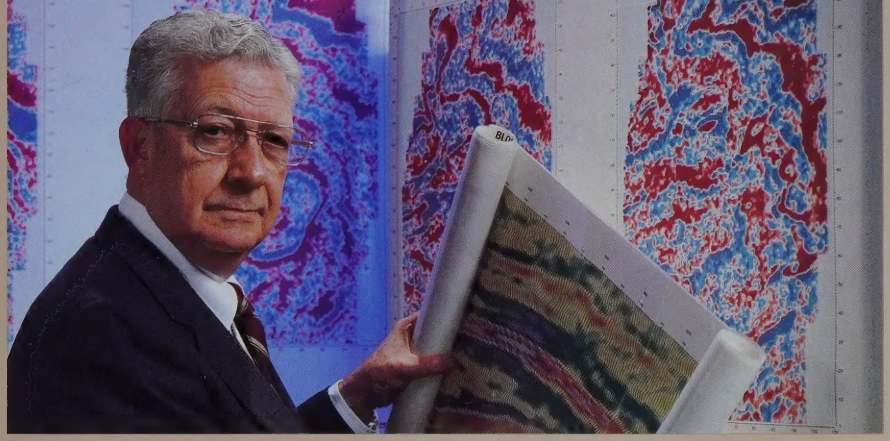
Debt and Preferred Stock Balances: An Improving Pattern

Total debt and preferred stock declined by more than $900 million in 1988. Key among 1988 developments were an early redemption of preferred stock ($212 million) and an early redemption of $800 million of floating rate notes.

Future principal payment obligations are modest, with an expected average of less than $300 million a year through 1994. Moreover, Phillips intends to continue prepaying and refinancing debt.

Cash Balances: A Strong Position

Cash flow has been strong enough in recent quarters to keep a cash balance generally in excess of $1 billion, while accommodating a higher level of capital spending, dividends and debt reduction. The company believes that holding cash in excess of operating needs gives an added measure of financial flexibility.



Upstream is where Phillips integration gets its start. Our operations produce the oil, natural gas and gas liquids that end up as gasoline, petrochemicals or plastics. Low prices have been a big problem the last year or so. But thanks to streamlining and higher production, our end of the business has stayed on a profitable course. We're well-set for any upturn in oil and gas prices.

L. M. Rickards,
executive vice president,
Upstream Operations

Upstream Operations

■ EXPLORATION & PRODUCTION

Exploration & Production contributes to Phillips integrated strengths by providing, directly or indirectly, much of the crude oil and natural gas converted into refined products and chemicals. E&P is the largest part of Phillips business, with assets of about $5 billion and some 7,800 employees.

Summary. E&P in 1988 reported higher operating profit in spite of lower oil prices. Crude oil and natural gas production rose. Phillips made discoveries in six countries and replaced the reserves it produced.

Lower Costs Buoy Profit

Exploration & Production operating profit for the year was $526 million versus $381 million in 1987. Contributing to the improvement were higher crude oil and natural gas production, higher domestic gas prices and lower expenses, partly offset by lower oil prices.

Phillips worldwide average crude oil price for 1988 was $14.11 a barrel, a decline of $2.91 from the previous year. Worldwide average gas prices were $1.88 a thousand cubic feet, the same as in 1987. Domestic gas prices, however, rose by 6 percent.

Results benefited from lower operating costs. Exploration expenses were down 14 percent, to $316 million, and lifting costs declined, primarily in Norway where costs in 1987 included a platform elevation project. U.S. depreciation, depletion and amortization expense was down as well.

Capital Expenditures Lower

During the year, $377 million of the company's capital expenditures were directed to exploration and production efforts, about 4 percent less than in 1987. Largest projects included the Audrey gas field development, the Ekofisk field waterflood and further development offshore the United Kingdom and offshore California.

For 1989, Phillips plans to devote 42 percent of its capital expenditure and investment budget—$406 million—to Exploration & Production. Major expenditures are planned for development programs offshore California and in the Gulf of Mexico, the Permian Basin and Canada. Overseas expenditures are planned for expansion of the Ekofisk field waterflood and for development projects in the U.K. North Sea and offshore Indonesia.

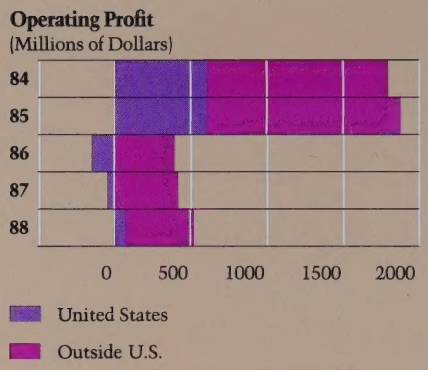
Secure Production, Reserves Among Key Strengths

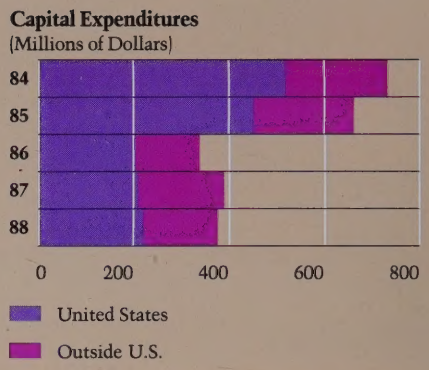
Competitive strengths include reserves and production concentrated in secure parts of the world, favorable finding and development costs and a sound reserves replacement record. About 50 percent of Phillips crude oil production and 72 percent of natural gas production came from the United States in 1988. The U.S. further accounted for 54 percent of the company's total proved reserves at year-end 1988.

Year's Chief Developments: Reserves Replaced, Production Higher

Reserves Replaced. In 1988, Phillips replaced 142 percent of the reserves it produced on a barrel-of-oil-equivalent basis during the year. Most of the additional reserves were booked in Norway, as a consequence of an expanded waterflood and other development projects.

Total worldwide proved reserves on a barrel-of-oil-equivalent basis were 1.86 billion barrels at year-end, up 4 percent. Both crude oil and natural gas reserves rose 4 percent, while natural gas liquids reserves ended the year up 2 percent.





PHILLIPS OIL AND GAS PRODUCTION

Net Production	**1988**	1987
	Barrels Daily	
Crude Oil		
United States	**109,900**	112,900
Norway*	**57,200**	46,000
Nigeria*	**20,000**	19,300
United Kingdom	**19,400**	21,800
Canada	**5,100**	5,000
Argentina	**4,300**	4,600
Cote d'Ivoire	**2,800**	4,400
Egypt	**1,800**	2,000
Indonesia	**1,500**	2,100
	222,000	218,100
	Millions of Cubic Feet Daily	
Natural Gas—Wet Basis		
United States	**851**	772
Norway**	**259**	241
United Kingdom**	**47**	43
Canada	**32**	30
	1,189	1,086

**Government-mandated production curtailments in effect.*
***Dry basis.*

Production Higher. Crude oil production averaged 222,000 barrels a day for the year, a 2 percent increase. Natural gas production rose 9 percent, mainly because of stronger demand in the United States.

• *United States.* Phillips U.S. crude oil production was slightly lower. Phillips completed, or participated in the completion of, 635 exploratory and development wells, versus 509 in 1987. U.S. capital expenditures were $220 million, compared with $210 million the prior year. Exploration expenses totaled $242 million, versus $294 million in 1987.

• *Norway.* Phillips share of crude oil production from the seven-field Greater Ekofisk Development, located in the Norwegian North Sea, rose by 11,200 barrels a day. The increase came as a result of the waterflood project and various development activities and was achieved despite a continuing 7.5 percent government-mandated curtailment in production.

• *United Kingdom.* Crude oil production from the Maureen field was down 11 percent for the year, because of the natural decline that occurs as fields mature. Phillips share of U.K. gas production increased 9 percent as the Audrey and Della fields came onstream.

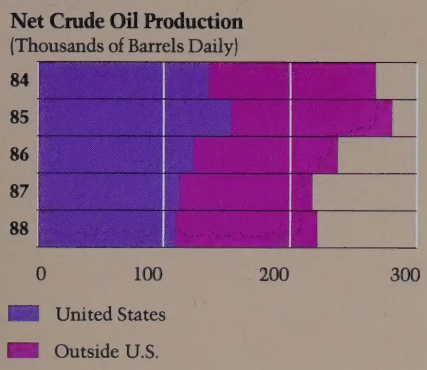
Discoveries in Six Countries. A significant discovery was made during the year at the South Eldfisk field, south of the Ekofisk field. Discoveries also were made in Canada, China, Nigeria, the United States and United Kingdom.

Additional Acreage Acquired. Phillips continued to build a portfolio of exploration prospects by acquiring 4.6 million net acres during the year. Of this total, 90,000 acres were in the Gulf of Mexico and Alaska. Acreage was also acquired in Canada, Pakistan, Gabon, the United Arab Emirates and in the Norwegian North Sea.

Ekofisk Waterflood Being Expanded. Phillips received permission from the Norwegian government to increase the size of the waterflood program that became operational in 1987. By extending the waterflood to the south end of the Ekofisk field and to other geological zones, Phillips estimates that an additional 160 to 170 million gross barrels of oil equivalent can be recovered over the life of the field. Development drilling is expected to be completed in 1994. Phillips is also considering the injection of nitrogen into the Ekofisk reservoir as a means of recovering additional oil and gas.

California Production Delayed. Production from the Point Arguello field was delayed when a local agency denied a necessary authorization. Steps are being taken to appeal this decision so that production can begin as soon as possible.

Cote d'Ivoire Operations Ended. Because of low oil prices and declining rates of production, Phillips ceased production from Cote d'Ivoire's Espoir field during the year.

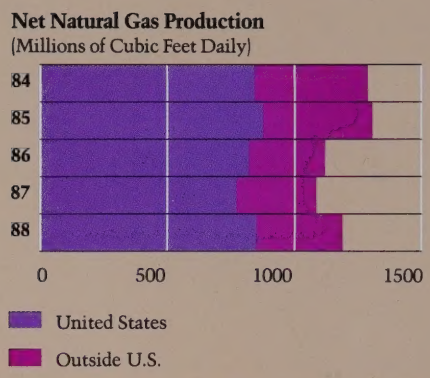


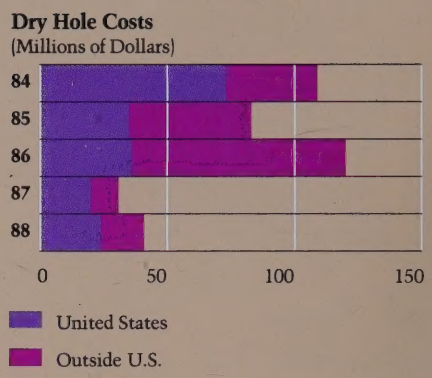
The Audrey platform jacket, shown here being hoisted onto a barge at Inverness, Scotland, was installed in the U.K. North Sea during 1988. The Audrey gas field began production in September, and at year-end averaged 56 million net cubic feet a day.

Mission: Operate Profitably in Low-Price Environment
Exploration & Production's main goal is to be profitable with energy prices as low as $15 a barrel for West Texas Intermediate crude oil and $1.20 a thousand cubic feet for U.S. natural gas. Accordingly, Phillips took further steps during the year to streamline operations. These included consolidating Exploration & Production and Gas & Gas Liquids into a single upstream organization, thus merging many common staff functions. Phillips upstream work force declined in 1988 by about 900 people, or 10 percent.

Strategy: Develop Discoveries for Early Cash Flow; Hold Production, Reserves Levels
A short-term strategy of Exploration & Production is to develop existing discoveries that can be brought onstream quickly, in order to generate early cash flow and maintain production and reserves at relatively stable levels for the next few years.

California. An addition to production will come from the company's Point Arguello field in the Santa Maria Basin offshore Southern California, where production will begin after





all regulatory approvals are received. Phillips share of production is expected to reach a daily rate of 20,000 barrels of crude oil and 11 million cubic feet of natural gas.

Gulf of Mexico. The company continued an active development program in the Gulf, participating in nine discoveries and 28 development wells, 27 of which were successful. Initial production of some 21 million net cubic feet of gas a day is expected from three blocks in 1989.

United Kingdom. Further steps were taken during the year to increase gas reserves and production off the southeast U.K. coast. Gas compression equipment was being installed at year-end to increase reserves and production in the Hewett-area fields. The Della field was connected to the Hewett system by subsea pipeline.

Indonesia. A second field in the Kakap block, offshore Indonesia, is expected to start production in 1990. Production from the initial Kakap field averaged 1,500 net barrels a day for the year.

Mature Basins. Phillips in 1988 participated in five discoveries in the Hardeman, Powder River and Hugoton basins, all in the United States, as well as seven discoveries in the province of Alberta, Canada. The Carlander field, in Sherman County, Texas, came onstream during the year and in 1989 is expected to reach maximum daily net production of 1,400 barrels of oil and 1.1 million cubic feet of gas.

Phillips has an extensive development program under way in northern Louisiana and East Texas, where 12 wells were completed in 1988. The program increased net gas production by 31 million cubic feet a day.

Enhanced Recovery. Some 373 secondary and tertiary enhanced oil recovery projects were operating at year-end, accounting for about one-third of Phillips U.S. crude oil production.

A waterflood project in Stonewall County, Texas, is expected to begin in late 1989 and increase production sevenfold by 1990, to 2,200 barrels of oil a day.

Strategy: Appraise Future Development Prospects

In addition to discoveries now being developed, Phillips is evaluating promising prospects that could add to production and reserves some five years or so into the future.

In 1988, the company finished interpretation of a 3-D seismic survey of J-Block, in the U.K. North Sea. An eighth successful well was drilled on the structure in 1988 with another well scheduled for 1989. Phillips is operator and has a 33 percent interest. Also, Phillips began discussion with the U.K. government regarding development and production of two gas discoveries made in 1987 near the Audrey gas field.

Appraisal wells drilled during the year confirmed a significant gas discovery on the Maggie prospect, located on blocks bordering the Maureen field. A seismic survey was in progress at year-end.

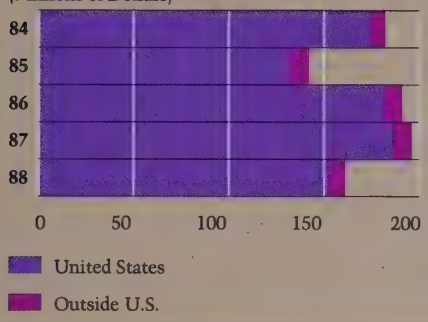
Development plans are in progress for the Alba field, in which Phillips has a 7.5 percent interest. Appraisal drilling during the year confirmed the presence of a large oil accumulation at Alba, which is located in the U.K. North Sea, 20 miles west of Maureen.

Strategy: Explore Areas With Good Potential for Adding Reserves

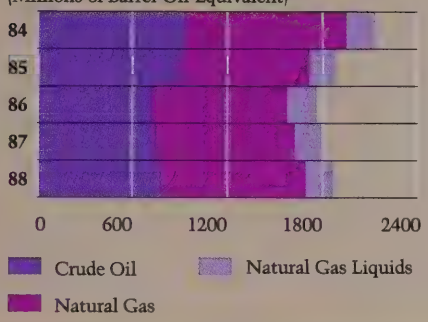
Phillips continues to search for oil and gas and acquire acreage in parts of the world that offer moderate risk yet have high potential for adding major reserves.

Gulf of Mexico. Phillips participated in 20 exploratory wells in the Gulf in 1988. At two federal lease sales, the company

Leasehold Impairment
(Millions of Dollars)

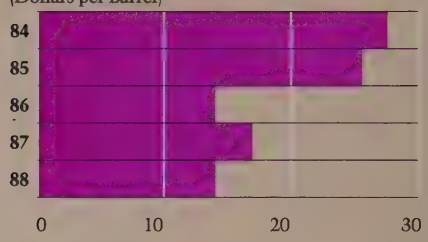


Worldwide Proved Reserves
(Millions of Barrel-Oil-Equivalent)



A crescent-shaped section of the Ekofisk tank barrier nears the staging area in Alfjorden, Norway, where it will undergo further construction. The barrier is scheduled for placement in the summer of 1989 and is a final step in alleviating the effects of subsidence at the Ekofisk field.

Average Worldwide Crude Oil Sales Price
(Dollars per Barrel)



Work progressed during the year to connect the Mustang Island 791 well, located 30 miles off the Texas coast. Natural gas production of about 7 million net cubic feet a day is expected to begin in 1989. Two other blocks in the Gulf of Mexico are slated to begin production in 1989 as well.

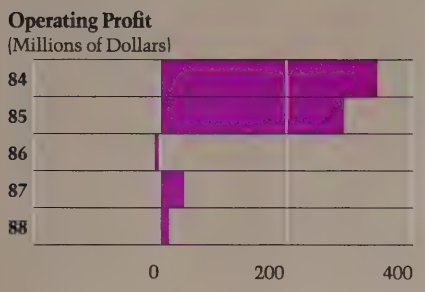
was the successful bidder for 15 tracts offshore Texas and Louisiana, involving 55,000 net acres. The company plans to participate in 17 exploratory wells in the Gulf in 1989.

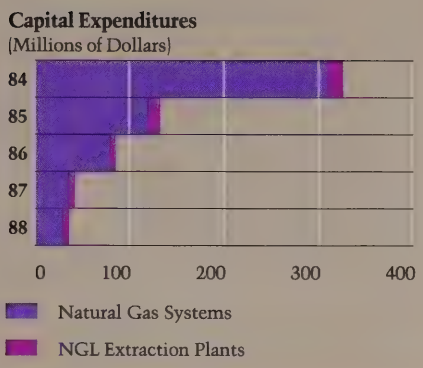
Alaska. Phillips acquired 15 tracts, comprising 35,000 net acres, offshore the Arctic National Wildlife Refuge (ANWR), one of the most promising areas of Alaska yet to be explored. Phillips also took part in an industry test well four miles northeast of the ANWR coastline during 1988.

Norway. An exploratory well is planned for 1989 on a license area in the Norwegian North Sea acquired during the year. In addition, a seismic study is under way to determine the need for further drilling in the South Eldfisk field.

Egypt. An exploratory well was drilled in the South Umbarka block, where Phillips holds 741,000 acres and is operator. Further exploratory drilling is planned for 1989.

Other Areas. Additional study and appraisal is planned in Pakistan, where an exploratory well was drilled during the year. Exploratory drilling is planned in Somalia, where Phillips holds substantial acreage. In 1988, a successful well was drilled offshore China, in an area where Phillips holds a 25 percent interest.





GAS & GAS LIQUIDS

Gas & Gas Liquids gathers, processes and markets natural gas, extracts natural gas liquids, sells liquefied natural gas, owns a gas pipeline system and manages the company's coal operations. G&GL is pivotal to Phillips integrated operations, furnishing gas liquids feedstock and fuel for the company's chemical and refining businesses.

Summary. G&GL had lower operating profit for the year. Gas liquids production was the same as last year. An agreement was renewed for the sale of liquefied natural gas to customers in Japan.

G&GL Profit Declines

Operating profit was $15 million in 1988, compared with $39 million a year earlier. Profit declined primarily because of lower natural gas liquids prices, partly offset by lower operating costs and higher residue gas prices.

Phillips will devote about 7 percent of its 1989 capital expenditure and investment budget, or $68 million, to Gas & Gas Liquids. Major expenditures will be made to connect new gas supplies to the company's gathering and processing systems. The largest project in 1988 was construction of a gas liquids plant in Utah.

Strengths: Extensive Supplies, Well-Situated Gathering Systems

Major competitive strengths of Gas & Gas Liquids include extensive natural gas supplies, well-situated gathering systems and efficient processing centers in gas-prone areas.

1988 Highlights: More Flexible Purchase Agreements, LNG Sales Extension

LNG Sales Extended. During the year, Phillips negotiated a 15-year extension to its liquefied natural gas (LNG) sales contract with two utility customers in Japan. Deliveries are made from the company's 70 percent-owned plant in Kenai, Alaska. The extension agreement calls for sales volumes rising to as much as 110 million cubic feet a day by 1994, an increase of up to 15 percent.

Phillips LNG sales averaged 99 million cubic feet a day in 1988, up 6 percent from 1987.

Gas Purchase Agreements Restructured. Phillips renegotiated a number of gas purchase contracts during the year to provide for a sharing of revenues by Phillips and natural gas producers. This "percent of proceeds" arrangement aligns the interests of the company and its producers by linking the price paid for producers' gas to the market price for both gas liquids and residue gas.

Leading Liquids Producer. Phillips continued as the country's largest producer of natural gas liquids, with production of 174,000 barrels a day, the same as in 1987.

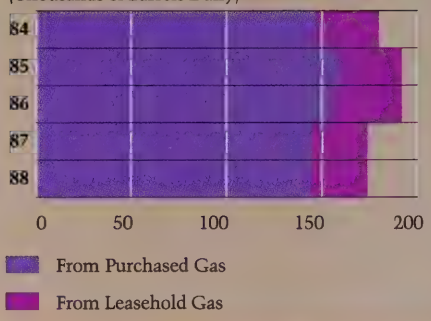
Residue gas sales were 1.17 billion cubic feet a day, compared with 1.19 billion cubic feet a day in 1987. The company processed 1.86 billion net cubic feet of natural gas a day during the year, down slightly from 1987. Asset sales and a low rate of drilling by gas producers were responsible for the decrease.

Natural Gas Supplies Higher. In addition to natural gas from its own exploration and production program, Phillips has access in the United States to extensive supplies of natural gas and natural gas liquids through purchase contracts and processing agreements. Gas & Gas Liquids buys about 80 percent of its natural gas supplies from third-party producers.

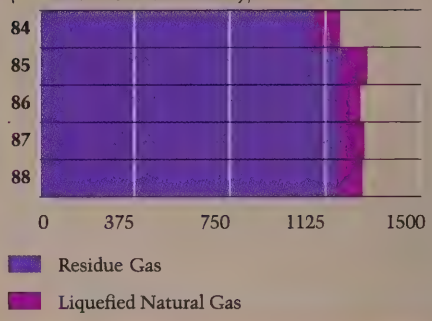
At year-end 1988, natural gas estimated available through outside purchase contracts and agreements totaled 3.53 trillion cubic feet, versus 2.37 trillion cubic feet at year-end 1987. Natural gas liquids

A worker helps load liquefied natural gas onto a tanker at Phillips plant in Kenai, Alaska. LNG is natural gas that turns to a condensed liquid when cooled, making long-distance shipment practical. During the year, Phillips extended an agreement to supply LNG customers in Japan.

U.S. Net NGL Plant Production
(Thousands of Barrels Daily)



U.S. Natural Gas Sales
(Millions of Cubic Feet Daily)



estimated available under outside purchase contracts and processing agreements were 452 million barrels at the end of 1988, compared with 296 million barrels the year before.

The increase is due to standardizing the method of calculating gas supplies, which is based on decline curve analysis using the average economic life of the leases in a geographic area.

Strategies: Reduce Costs, Strengthen Direct Sales

Gas & Gas Liquids is continuing to consolidate nonstrategic or unproductive assets as well as to gain access to more gas supplies. To secure higher prices for residue gas sales, Phillips is marketing a growing share of natural gas directly to local distribution companies, municipalities and other end-users.

Further Steps Taken to Develop Lignite Reserves

During the year, Phillips entered into an agreement to supply lignite to a Louisiana utility and formed two joint-venture companies to help develop lignite reserves in Louisiana and Texas. Phillips holds rights to about 6.8 billion tons of lignite coal, mainly in Gulf Coast states.

Downstream is the value-added arm of the oil industry. How much value? Our businesses made well over a billion dollars in pretax profit in 1988, nearly twice as much as in any previous year. It couldn't happen, though, without our own feedstocks and technology. In my book, that's what being integrated is all about.

B. M. Thompson,
executive vice president,
Downstream Operations

Downstream Operations

■ PETROLEUM PRODUCTS

Petroleum Products encompasses Phillips refineries, pipelines and terminals, as well as the marketing of gasoline, propane and other petroleum products. Petroleum Products is a margin business, meaning profit is determined mostly by the market value of products sold, such as gasoline, less feedstock and manufacturing costs.

Summary. Petroleum Products had one of its best years in 1988. The company continued a program of upgrading Phillips 66 stations owned by independent marketers and building high-volume retail marketing outlets owned and operated by the company. Branded gasoline sales rose strongly. Construction neared completion of a new alkylation unit at the Sweeny, Texas, refinery to boost output of high-octane gasolines.

Higher Sales, Margins Bolster Profit

Operating profit for Petroleum Products was $471 million in 1988, compared with $201 million a year earlier. The increase was largely the result of higher sales volumes and improved margins, particularly for gasoline.

About 19 percent of Phillips 1989 capital expenditure and investment budget—$181 million—will go to Petroleum Products. Major expenditures will be made for retail marketing outlets, pipelines and terminals, refinery improvements and construction of a hazardous waste incinerator at the Sweeny refinery. The biggest project of 1988 was continued construction of the Sweeny alkylation unit.

Strengths: Secure Feedstocks, Sophisticated Refineries

Phillips has access to a secure source of feedstocks for its refineries and other downstream operations. Moreover, the company operates sophisticated refineries that consistently run at near 100 percent of rated capacity.

Phillips two Texas refineries function as hydrocarbon upgrading centers, processing both crude oil and natural gas liquids, while yielding both petrochemicals and petroleum products.

Highlights: Higher Sales, Refinery Runs Strong

Product Sales Strong. Phillips U.S. motor fuel sales volumes rose by 8 percent, marking a sixth straight year of increase. The improvement reflects an aggressive effort to market more Phillips 66 brand products. U.S. sales volumes of distillates were up slightly.

U.S. sales volumes of natural gas liquids products rose by 3 percent from 1987, primarily because of high demand for ethane as a petrochemical feedstock.

Refineries Running At Peak Level. Phillips operated its three U.S. refineries near 100 percent of rated capacity for a third straight year, compared with a 1988 industry average of 84 percent.

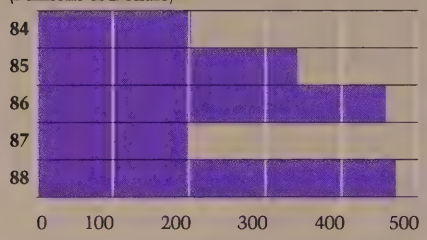
Crude runs for the year were 301,000 barrels a day, about the same as in 1987. Domestically produced oil accounted for 77 percent of the runs, the same as the previous year.

The cost of crude oil delivered to Phillips refineries was $15.20 a barrel, $3.25 lower than in 1987. High-sulfur crude oil, a lower-cost source of gasoline and petroleum products production, accounted for 74 percent of crude processed, compared with 66 percent in 1987.

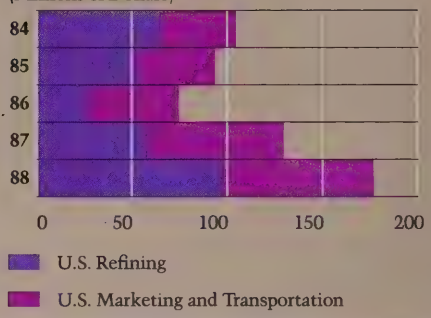
Phillips processed 199,800 barrels of natural gas liquids a day, up 2 percent from the previous year. The cost of natural gas liquids declined for the year.

Motor fuel sales from company-operated stations like this one in Tulsa, Okla., were up by 25 percent in 1988. Phillips continues building company-operated stations in selective areas, while encouraging its independent marketers to upgrade and modernize their stations.

Operating Profit
(Millions of Dollars)



Capital Expenditures
(Millions of Dollars)



Brand Making Further Strides. The company took steps to make its brand more visible by building or renovating 40 Phillips-operated stations, many of them in high-traffic areas. Company-operated stations account for little more than two percent of total Phillips outlets but generated more than 10 percent of company gasoline sales in 1988.

Motor fuel sales volumes from company-operated stations increased by 25 percent during the year, while branded volumes sold to independent marketers rose 6 percent.

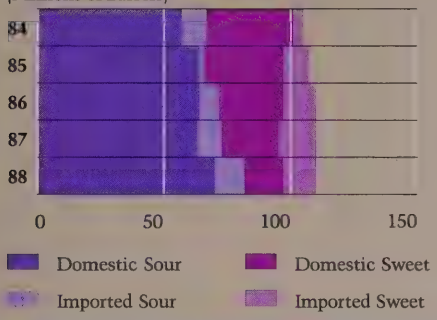
In addition, 674 more Phillips 66 stations owned and operated by independent marketers were upgraded to meet the image and appearance standards set by the company. Phillips provided $11 million of assistance to its marketers in these efforts.

Thanks to a continuing credit card emphasis, Phillips achieved record credit sales in 1988. Some 4.5 million motorists carried Phillips 66 credit cards at year-end.

Sales of premium unleaded gasoline rose by 34 percent, as it gained increasing acceptance in the marketplace and became more widely available.

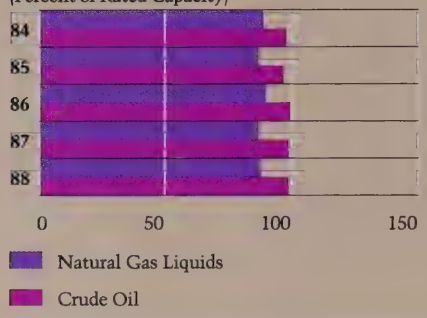
At year-end, there were some 11,000 Phillips 66 marketing outlets in 28 states. Of these, 233 were operated by the company.

Refinery Crude Oil Runs
(Millions of Barrels)

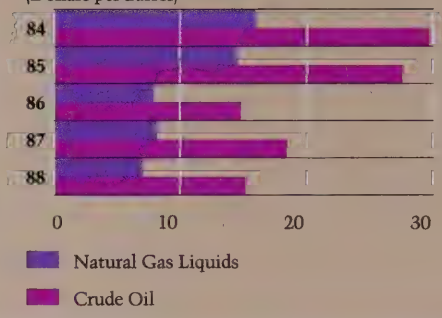


Construction continued in 1988 on a new HF alkylation unit at the Sweeny refinery. When complete in 1989, the unit will increase alkylation capacity by 5,000 barrels a day, permitting higher production of premium-grade motor fuel.

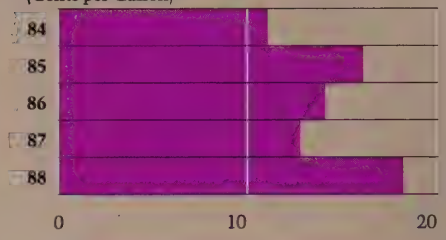
Refinery Crude Oil and Natural Gas Liquids Capacity Utilization Rates
(Percent of Rated Capacity)



Average Cost of Refinery Feedstocks
(Dollars per Barrel)



Margin of Motor Fuel Sales Price Over Crude Oil Feedstock Cost
(Cents per Gallon)



Strategies: Produce More High-Value Products, Increase Branded Sales

Produce More High-Value Products. Phillips continues making improvements to its refining system to allow for greater production of high-value products such as mid-grade and premium gasoline. A new HF alkylation unit at the Sweeny refinery is expected to go into operation in 1989, increasing production of high-octane motor fuel by about 5,000 barrels a day.

Increase Branded Sales. Branded sales, a good indicator of customer preference for products bearing the Phillips 66 trademark, rose for the sixth straight year, exceeding 90 percent of total company-retail and independent-marketer motor fuel sales in 1988. Phillips emphasis on branded sales results in higher overall sales volumes and profit.

The company plans to build further support for branded sales by stricter enforcement of appearance standards, while building modern company-operated stations and encouraging marketers to continue modernizing their own stations.

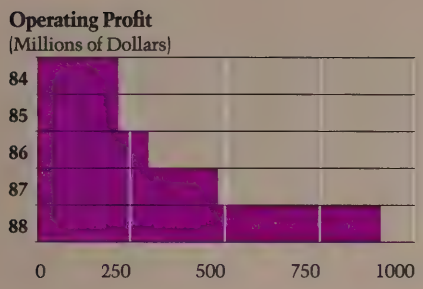
Refinery Crude Oil and Natural Gas Liquids Capacities and Runs—Thousands of Barrels Daily

	Crude Oil		Natural Gas Liquids	
	Capacity	Runs	Capacity	Processed
1988				
Sweeny, Texas	**175**	**175**	**90**	**90**
Borger, Texas	**105**	**102**	**95**	**82**
Woods Cross, Utah	**25**	**24**	**—**	**—**
Conway, Kansas	**—**	**—**	**42**	**28**
	305	**301**	**227**	**200**
1987				
Sweeny, Texas	175	176	86	88
Borger, Texas	105	102	95	79
Woods Cross, Utah	25	24	—	—
Conway, Kansas	—	—	42	28
	305	302	223	195

Major Products Produced Per Barrel of Crude Runs

	1988	1987
Automotive gasoline	**61%**	61
Aviation fuels	**13**	12
Distillates	**28**	30
Residual products	**2**	1

Phillips blends natural gas liquids into automotive gasoline, enabling the company to have one of the highest percentages of gasoline produced per barrel of crude oil runs.



An employee of the Driscopipe plant in Brownwood, Texas, stacks sections of the company's premium-grade pipe. A major purchaser of Phillips polyethylene resins, Driscopipe had record sales volumes in 1988. The pipe shown here is sold mainly in municipal and industrial markets.

CHEMICALS

Phillips chemicals business converts natural gas liquids and other feedstocks into products of greater value, such as olefins and plastics. Chemicals has been operating at peak levels in recent years, thanks to strong demand.

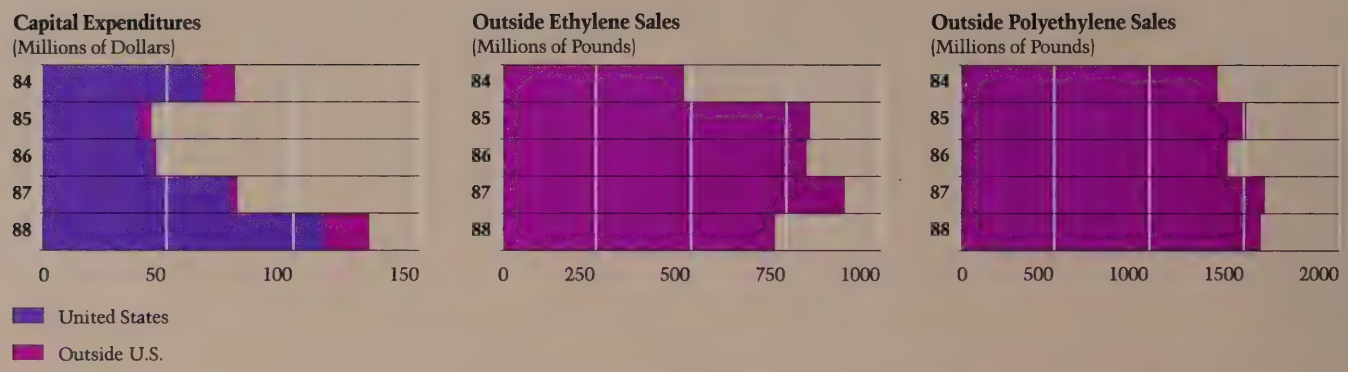
Phillips chemicals business consistently ranks as one of the most profitable in the oil industry.

Summary. Chemicals had its best year in 1988. Overall sales volumes were at record levels and prices for core products improved significantly during the year. Several projects to increase production were announced or in progress at year-end.

Profit at Record Level

Chemicals had operating profit of $911 million, compared with $482 million in 1987. The increase came on the strength of higher prices, especially for olefins and plastic resins, and improved margins.

In 1989, Phillips plans to direct 21 percent of its capital expenditure and investment budget, or $208 million, to chemicals operations. Major expenditures will go to increase ethylene capacity, as well as to expand output of polyethylene and specialty plastics. The largest capital expenditures in 1988 were made for capacity and efficiency



improvement projects in ethylene, polyethylene and K-Resin polymer.

Strengths: Secure Feedstock, Sound Research

Chemicals is a crucial part of the company's integrated operations, upgrading natural gas liquids into products of greater value. Moreover, Phillips own natural gas liquids business—the country's largest—assures ample feedstock.

In addition, Chemicals is backed by a strong research and development team, which continues to develop new products, especially polymers. Several pilot plants are being built at Phillips research facilities to speed development of new products or processes.

Highlights: Operations at Full Capacity, Large-Scale Expansions Taking Place

Sales Climb, Capacities Loaded. In response to higher demand, capacity utilization for all major product groups averaged nearly 100 percent for the year.

• *Olefins, Polyolefins.* Benefiting from strong demand, this segment generated about 80 percent of Chemicals' operating profit. Products in this category include ethylene and propylene, as well as polyethylene and polypropylene.

Ethylene and polyethylene sales were down from 1987, due to the scarcity of large volumes for purchase and resale. But propylene and polypropylene volumes rose substantially, benefiting from a large increase in polypropylene capacity that came onstream in late 1987. Prices and margins for these products were up for the year.

• *K-Resin.* Sales were up sharply as a consequence of improved demand and higher capacity. K-Resin polymer is a clear plastic used in containers and packaging. Worldwide sales volumes of Ryton engineering plastics were flat.

• *Driscopipe.* Phillips Driscopipe Inc. reported higher sales volumes for a sixth consecutive year. The subsidiary manufactures polyethylene pipe mainly for utility and industrial uses. Driscopipe will introduce a new product in 1989 for use in the large-diameter pipe market dominated by concrete.

• *Fibers.* Sales volumes declined for Phillips Fibers Corporation, a subsidiary that manufactures polypropylene fibers for use in carpets and furnishings. Margins fell as higher raw material costs could not be fully recovered through higher prices.

• *Other Products.* Despite soft oil prices, revenues rose strongly for Phillips extractive chemicals business. The drilling mud additives and oilfield chemicals business showed significant improvement, and sales of mining chemicals were at record levels. Catalyst Resources, Inc., a manufacturer of catalysts for plastics manufacturing, had higher production levels and revenues.

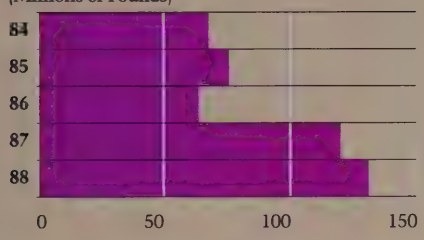
Ethylene/Polyethylene Expansions Announced. During the year, Phillips announced plans to build a new ethylene plant at Sweeny, Texas. The plant's production capacity of ethylene, a major constituent of many plastics, would be approximately 1.5 billion pounds a year. Phillips is attempting to arrange for the plant to be owned by a partnership in which the company would hold a 50 percent interest. Plans also were announced to increase high-density polyethylene capacity at the company's Houston Chemical Complex by 275 million pounds a year, or nearly 20 percent.

In 1988, projects were completed to raise K-Resin polymer capacity by 20 percent and high-density polyethylene capacity by 8 percent.

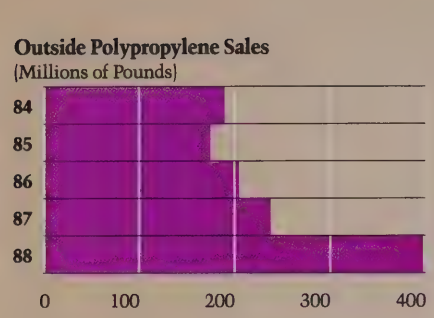
Strategies: Adding Capacity, Products and Markets

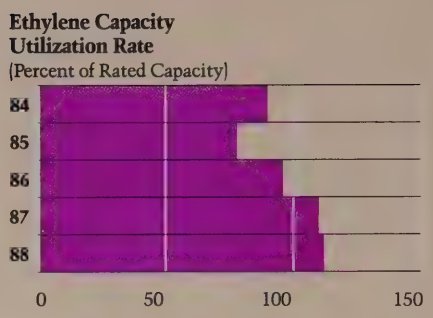
Bringing on New Capacity. Chemicals had four major expansions announced or in progress at year-end, involving a total capital cost of more than $500 million. Included are capacity

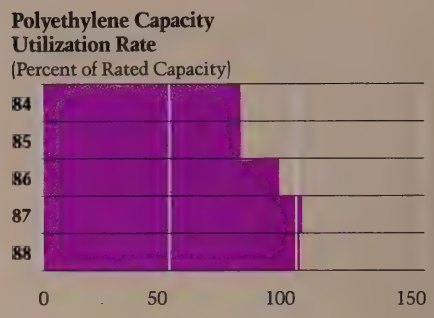
Outside Propylene Sales
(Millions of Pounds)



The heart of Phillips plastics operations, the Houston Chemical Complex glows in a Texas sunset. The facility produced some 2 billion pounds of polyethylene, polypropylene and K-Resin polymer in 1988 and is the scene of several expansions.







increases for ethylene, propylene, polyethylene and K-Resin polymer. A project boosting polypropylene capacity by 70 percent was finished in 1987.

Developing New Products. Phillips plans to continue commercializing new products based on its own technology. Three products developed by company researchers were introduced in 1988. Crystalor polymethylpentene is a transparent thermoplastic resin targeted for use in packaging, medical and laboratory ware. Crystalor resin is much like a high-performance polypropylene.

A line of thermoplastic polyester compounds also debuted in 1988. Aspect polyester compounds are intended to complement the company's Ryton engineering resins and are well-suited for electrical, electronic and automotive uses.

Also during the year, Phillips introduced a versatile polypropylene fiber with improved resilience, for use in auto interiors.

Reaching Out for New Markets. Phillips expects to follow a strategy of "selective globalization" to meet growing overseas demand for petrochemicals and plastics. Although revenues from export sales are significant for polyethylene and K-Resin polymer, as well as for specialty chemicals and aromatics, they account for only about 15 percent of Phillips total chemical revenues.

Partly because of the high cost of transporting petrochemicals, Phillips is considering locating new production facilities overseas in the years ahead. During 1988, the company increased its ownership of a high-density polyethylene plant in Singapore and announced a new resin compounding and blending business there. Joint ventures to produce or compound Ryton engineering plastics got under way in Japan and Europe.

	Millions of Dollars				
Operating Revenues	**1988**	1987	1986	1985	1984
Petrochemicals	**$1,034**	836	748	1,097	1,092
Plastic resins	**1,155**	783	622	625	638
Synthetic fibers	**163**	158	146	139	127
Plastic pipe	**130**	101	87	91	93
Other sales and services	**36**	50	28	47	95
Sold operations	**—**	—	67	267	306
	$2,518	1,928	1,698	2,266	2,351

How important is technology to an integrated company like Phillips? It's the necessary ingredient that grows our business and helps turn good ideas and raw materials into new products. We have to stay in the forefront of technology, so we can maintain—and sharpen—our competitive edge in the marketplace.

D. J. Tippeconnic,
senior vice president,
Planning & Technology

Technology

Research and development contributes to Phillips integrated operations by developing new products and improving existing ones, nearly all of which are derived from hydrocarbons. Phillips research has been particularly successful at developing profitable lines of plastics.

Summary. During the year, Research & Development started up several new pilot plants and made further advances in polymers. The Bartlesville hazardous waste incinerator destroyed its five-millionth pound of waste. A new fermentation products plant started up.

New PMP Pilot Plant Built, Plastics Developments Highlight Year

PMP Pilot Plant. Design and construction of a 250,000-pound-a-year pilot plant to support market development of Crystalor polymethylpentene was completed at the Bartlesville Research Center during the year. The facility will be expanded to a capacity of 1 million pounds in 1989. Polymethylpentene is a clear plastic being developed by Phillips for, among other uses, microwave cookware and the packaging of foods as well as medical and laboratory ware.

Plastics Developments. Phillips researchers developed a catalyst for the manufacture of a new, tougher polyethylene film. The film will be produced at the Houston Chemical Complex for use in trash bags, grocery sacks and packaging.

Also developed in 1988 was a K-Resin material with improved resistance to stress cracking and to permeation by fatty foods. Market development of the product, which is to be used primarily for food packaging, will begin in 1989.

Aspect polyester compound was commercialized, while development of engineering thermoplastics based on Aspect and other new compounds continued. These glass-reinforced plastics, resistant to heat, chemicals and corrosion, are intended to supplement Ryton engineering materials.

Market development for a new high-temperature advanced composite material for the aviation and aerospace industries began in 1988. Another composite material, capable of withstanding temperatures as high as 400 degrees F., also was developed and is expected to begin production in 1989 at the Ryton pilot plant in Bartlesville.

Pharmaceutical Research Curtailed. Phillips ended most in-house pharmaceutical research in 1988, as research efforts were refocused in more direct support of core businesses. Phillips is fulfilling its commitments to existing biotechnology joint ventures but is not entering into further such ventures. Research and development support continued for Provesta Corporation, Phillips biotechnology subsidiary.

Provesta. A new fermentation products plant located in Bartlesville reached commercial production late in the year. The plant can produce 3 million pounds a year of dried yeast products, based on Phillips high-cell protein technology. The fermentor was named one of the year's 10 outstanding engineering achievements by the National Society of Professional Engineers.

Incinerator Milestone. The hazardous waste incinerator at the research center in Bartlesville processed its five-millionth pound of waste during 1988. Meanwhile, Incinatrol Inc., a company owned by a Phillips subsidiary, completed its first full year engaged in the business of commercial hazardous waste incineration.

Bartlesville Research Center employees Rick Kinder (left), Larry Nash and Nancy Knight review plans for a new K-Resin pilot plant under construction in the background. The facility, which will start up in 1989, will help speed development of new plastics and processes.

Specialty Chemicals. Production of more than a dozen specialty chemical products considered to have high marketing potential was transferred during the year from the Bartlesville Research Center to larger production facilities. Uses for some of these chemicals include medical products, flavors and fragrances, and lubricants.

Other Developments. The company developed and licensed a new catalyst that converts carbon monoxide into carbon dioxide. The catalyst has several potential health, environmental and defense uses, such as extending the life of the military's laser rangefinder.

Phillips also began licensing its biotechnology production system, signing agreements with two pharmaceutical companies.

Patent Pacesetter. Phillips received 153 U.S. and 339 foreign patents in 1988. At the end of the year, the company held 4,450 active U.S. patents, the most of any oil company.

High school students learn about the hazards of drug and alcohol abuse thanks to information programs sponsored by TARGET. With support from companies like Phillips, TARGET's message promoting a healthy lifestyle has reached millions of young people across the country.

People & Citizenship

Phillips strives to be a good citizen and neighbor as well as a sensitive employer. Thus, the company invests not only in new plants and equipment but also in youth, education and a high quality of life. Responsible citizenship extends to safeguarding the environment and working for programs to encourage oil and gas exploration in stable parts of the world. As an employer, Phillips prides itself on encouraging employees to get involved in decision making and places the highest priority on safety in the workplace.

Phillips Recognized as Safety Leader

Phillips was honored during the year by the American Petroleum Institute as the U.S. oil industry's safest member, based on the rate of injuries requiring time off from work that occurred at company sites in 1987.

The company continued to compile a strong safety record in 1988, as recordable injuries fell by 6 percent and lost workday cases occurred at virtually the same rate as in 1987. No employee fatalities took place on the job during the year. Property loss increased but was better than the projected rate.

$155 Million Spent to Protect Environment

Capital expenditures of $49 million were approved to protect and improve the environment in 1988, while another $106 million was spent on existing environmental control systems. During the year, a new company-developed process for recovering sulfur from natural gas was installed at a facility in Texas. To help ensure compliance with environmental regulations, Phillips in 1988 conducted safety and environmental reviews at 32 locations.

Charitable Donations Top $5 Million

In 1988, Phillips contributed $5.2 million to organizations involved in youth, civic, cultural, educational, health and welfare activities. Of this, $3 million went to education. Some 450 colleges and universities benefited from this support.

Amateur Swimmers, Divers Receive Company Support

Phillips continued in 1988 as national sponsor of United States Swimming and United States Diving. The organizations sponsor swimming and diving clinics and competitions for youngsters, and they help prepare U.S. athletes for the Olympics. All 31 of the U.S. swimming and diving medalists in the 1988 Summer Olympics took part in meets sponsored by Phillips earlier in their careers. The company has been national sponsor of U.S. Swimming since 1973 and U.S. Diving since 1979.

Phillips Continues Work Force Consolidations, Reductions

Upstream businesses—Exploration & Production and Gas & Gas Liquids—were consolidated during the year for the sake of greater efficiency. Among other steps, significant personnel reductions took place at Phillips offices in Bartlesville, Oklahoma City and Denver.

Phillips environmental review teams visited 32 company sites in 1988. The teams, one of which is shown here at the Woods Cross refinery, help local managements stay abreast of ever-changing environmental regulations.

In addition, Phillips sold its Applied Automation subsidiary, employing some 360 people, to a West German company. Phillips year-end work force stood at 21,000, down 1,500 from the previous year.

Employees to Have Larger Stake in Company

The company adopted a program in 1988 to help increase common stock ownership by employees. Under the Long-Term Stock Savings Plan, employees will be allocated 14.3 million shares of common stock over a 10-year period beginning in July 1989. The stock savings plan bought the shares from Phillips in 1988 with a $250 million loan effectively guaranteed by the company.

Employee Programs Seek Out Savings

In the company's suggestion plan, 70 suggestions were submitted for each 100 eligible employees, versus 81 in 1987. First-year tangible savings from employee suggestions were $13.1 million, compared with $16.5 million the previous year. Employees received a total of $1.1 million for their suggestions. The highest award paid in 1988 was $42,400.

Savings achieved through the company's Participative Action Teams totaled $16 million, versus $7.2 million the previous year. These teams, involving 1,450 employees, meet to solve work-related problems and encourage innovation.

Some 43,000 shares of common stock were distributed through the Special Stock Award program, designed to salute outstanding performance by employees.

Phillips Helps Shape National Energy Policies

Phillips continued efforts to shape national policies that might have a substantial effect on its performance. To this end, the company concentrates on influencing the outcome of specific issues such as access to public lands for energy development, fair tax and trade policies and reasonable environmental rules. During 1988, Phillips was successful in helping repeal the Windfall Profit Tax on crude oil production.

Corporate Mission and Values Outlined

In response to the many changes that have taken place within Phillips in recent years, management met in the spring to reflect on the company's guiding mission and to spell out the values that have nurtured the corporation for nearly three generations.

The group defined Phillips mission as "To enhance the value of our shareholders' investment by using the strengths of our people and our integrated operations to provide our customers with products that are high in quality and competitive in price."

Foremost among Phillips values is a high regard for the individual, ethics, safety and a clean environment. The mission and values statement was intended to give employees, customers and shareholders a more thorough appreciation of what Phillips stands for.

Financial Review 1988

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Oil and Gas Operations

In accordance with Financial Accounting Standards Board (FASB) Statement No. 69, "Disclosures about Oil and Gas Producing Activities," and regulations of the Securities and Exchange Commission (SEC), the company is making certain disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that some of the data are necessarily imprecise and represent only approximate amounts because of the subjective judgments involved in developing such information. Accordingly, this information may not necessarily represent the present financial condition of the company or its expected future results.

February 15, 1989

HIGHLIGHTS

Consolidated net income for 1988 was $650 million, compared with $35 and $228 million for 1987 and 1986, respectively. Total revenues for 1988 were $11.5 billion, compared with $10.9 billion for 1987 and $10.0 billion for 1986.

The company's Downstream Operations doubled their pretax earnings in 1988, reflecting continued strong product demand. Upstream Operations pretax earnings rose 29 percent in spite of lower crude oil prices, reflecting higher gas production and higher U.S. gas prices as well as lower expenses.

The increase in earnings and continued strong cash flow from operations enabled the company to strengthen its financial position. In addition, the following are some of the year's highlights:

- In 1988, the company reduced total debt and preferred stock by over $900 million.
- In July 1988 and again in January 1989, the company raised the quarterly dividend paid to common stockholders by a cumulative 47 percent over the quarterly dividend paid in 1987.
- During the year, the company regained an investment-grade rating on its debt which allows the company greater financial flexibility for future borrowing or refinancing of existing debt on more favorable terms.
- The company replaced all the hydrocarbons it produced in 1988 through revisions to estimates of existing reserves, enhanced oil recovery programs, primarily in Norway, and reserve discoveries.

Summary of Income

Years Ended December 31	Millions of Dollars		
	1988	1987	1986
Petroleum			
Exploration and Production			
United States	**$ 77**	(44)	(146)
Outside United States	**449**	425	401
	526	381	255
Gas and Gas Liquids	**15**	39	(8)
Refining, Marketing and Transportation	**471**	201	458
	1,012	621	705
Chemicals	**911**	482	299
Corporate and Other	**(808)**	(837)	(330)
Income before Income Taxes	**1,115**	266	674
Income Taxes	**465**	231	446
Net Income	**$ 650**	35	228

RESULTS OF OPERATIONS

Consolidated net income for 1988 increased $615 million over the $35 million reported in 1987. This significant increase was due primarily to higher sales prices for chemical products, improved margins for petroleum products, foreign currency gains in 1988 versus losses in 1987, and higher gas revenues resulting from higher worldwide production and higher U.S. prices. Upstream Operations also benefited from lower expenses. Demand remained strong for petroleum products, chemicals and plastics which enabled the company's refineries and plants to run at capacity. These factors were partially offset by lower crude oil prices.

The following demonstrates the change in 1988 average sales prices, compared with 1987:

	1988	1987	Change
Exploration and Production			
Crude Oil (per barrel)			
United States	**$13.41**	16.35	(18)%
Outside United States	**14.77**	17.69	(17)
Worldwide	**14.11**	17.02	(17)
Natural Gas—Lease (per thousand cubic feet)			
United States	**1.53**	1.45	6
Outside United States	**2.60**	2.77	(6)
Worldwide	**1.88**	1.88	—
Gas and Gas Liquids			
U.S. Residue Gas (per thousand cubic feet)	**1.63**	1.50	9
U.S. Natural Gas Liquids (per barrel—unfractionated)	**6.96**	8.11	(14)
Petroleum Products			
U.S. Natural Gas Liquids (per barrel—fractionated)	**10.04**	11.14	(10)
Automotive Gasoline (per gallon)	**.54**	.57	(5)
Distillates (per gallon)	**.48**	.54	(11)
Liquefied Petroleum Gas (per gallon)	**.26**	.28	(7)

The company's 1988 worldwide production of crude oil, natural gas and natural gas liquids increased 2, 9 and 2 percent, respectively, over 1987 levels, in spite of continuing government-mandated curtailments in certain areas. The increase in natural gas production was primarily due to increased demand in the United States.

Exploration and Production

Pretax earnings for 1988 were $526 million, compared with $381 and $255 million in 1987 and 1986, respectively.

Domestic operations reported pretax earnings of $77 million, compared with pretax losses in 1987 and 1986 of $44 and $146 million, respectively. The improvement in 1988 was due primarily to both higher natural gas prices and production, lower exploration expenses, and lower depreciation, depletion, amortization and retirements. These factors were partly offset by lower crude oil prices.

Pretax earnings outside the United States were $449 million in 1988, compared with $425 million in 1987 and $401 million in 1986. The increase in 1988 resulted from lower lifting costs in Norway, partially offset by lower crude oil revenues resulting primarily from lower prices. Lifting costs were higher in 1987 due to costs associated with the elevation of six platforms in the Norwegian North Sea.

Gas and Gas Liquids

Pretax earnings were $15 million in 1988, compared with $39 million in 1987 and a pretax loss in 1986 of $8 million. Lower natural gas liquids prices and higher natural gas purchase costs, partly offset by higher residue gas prices and lower operating expenses, were responsible for the decline in 1988.

Refining, Marketing and Transportation

In 1988, pretax earnings were $471 million, compared with $201 and $458 million in 1987 and 1986, respectively. Improved margins, particularly for motor fuel, plus higher sales volumes for petroleum products enabled earnings to more than double in 1988.

Chemicals

Chemicals had a record year in 1988 reporting pretax earnings of $911 million versus $482 million in 1987 and $299 million in 1986. This increase was due to improved margins caused mainly by higher sales prices for olefins and plastics.

Corporate and Other

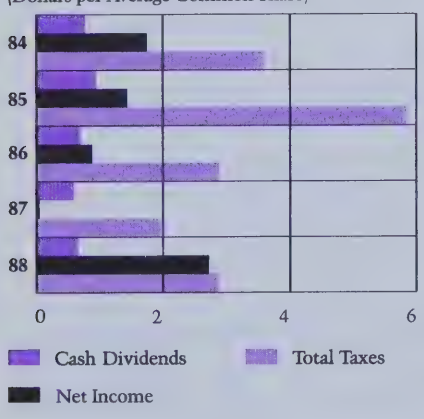
Corporate and Other reported a pretax loss of $808 million in 1988, compared with pretax losses of $837 and $330 million in 1987 and 1986, respectively. The slight improvement in 1988 was due primarily to lower interest expense and gains from asset sales, partly offset by lower earnings from the company's other operations.

Provision for Income Taxes

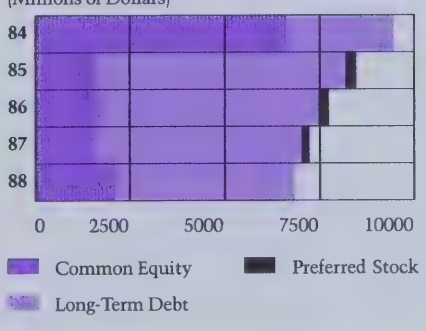
The provision for income taxes was $465 million in 1988, compared with $231 million in 1987 and $446 million in 1986. Higher pretax earnings in 1988 were the primary factor for the increase. The effective income tax rate for 1988 was 42 percent, compared with 87 percent in 1987 and 66 percent in 1986. The primary reasons for the decline in the effective tax rate were the significant increase in domestic earnings, which are generally taxed at lower rates than aggregate foreign earnings, the effect of the strengthening of the U.S. dollar on certain foreign tax liabilities and the favorable adjustment of tax provisions for foreign tax issues.

The company does not intend to adopt FASB Statement No. 96, "Accounting for Income Taxes," until it has had an opportunity to analyze a special report, to be published by the FASB, concerning Statement No. 96 implementation issues. If the company were to adopt Statement No. 96 effective January 1, 1989, as originally promulgated, the one-time benefit to net income resulting from the cumulative effect of a change in accounting principle would approximate $150 million.

Total Taxes, Net Income and Cash Dividends
(Dollars per Average Common Share)



Capitalization
(Millions of Dollars)



CAPITAL RESOURCES AND LIQUIDITY

The company's current ratio, the ratio of current assets to current liabilities, was 1.2 at year-end 1988, the same as in 1987. Net cash provided from operating activities was sufficient to cover the company's capital expenditures, dividends and approximately $900 million of the reduction in total debt and preferred stock.

The company's short-term liquidity position was approximately $326 million stronger than indicated because 87 percent of product inventories are valued using the last-in, first-out (LIFO) method. The LIFO method values inventories at historical costs which are lower than current prices.

Total debt and preferred stock declined by more than $900 million during 1988. This decrease primarily resulted from the redemption of all the outstanding shares of the Series A preferred stock for $212 million at the mandatory redemption price of $25 per share, and the early retirement of $1.1 billion of Floating Rate Senior Notes Due 1995 which was financed by internally generated cash and the issuance of $700 million in new debt. In 1988, the company issued $250 million of commercial paper and borrowed $200 million under a new bank line of credit which expires in 1995. Also in 1988, the company sold 14,336,918 shares of authorized but previously unissued common stock to the Long-Term Stock Savings Plan (LTSSP) for $250 million. The LTSSP issued $250 million in notes payable to purchase the shares and will repay the notes (plus interest) over a 10-year period using company contributions and dividends received on the shares of common stock that have not been allocated to plan participants.

Phillips worldwide operations are capital intensive requiring significant capital investments over long construction periods. Capital expenditures for properties, plants and equipment totaled $797 million in 1988, compared with $737 million in 1987 and $646 million in 1986. During the past three years, significant expenditures have been made for developing the Point Arguello field in the Santa Maria Basin offshore California and the waterflood project in the Norwegian North Sea; for developing existing domestic properties and connecting new gas to existing facilities; for modernizing and improving the feedstock flexibility of Phillips major refineries; and for modernizing Phillips retail marketing outlets. During this period, approximately 75 percent of the company's capital expenditures were made in the United States. Over the 3-year period, capital expenditures directed toward Exploration and Production projects accounted for 51 percent of the total; Gas and Gas Liquids—8 percent; Refining, Marketing and Transportation—17 percent; Chemicals—12 percent; and Corporate and Other—12 percent.

In addition to expenditures for properties, plants and equipment, other investments of $102 million were made in 1988 in subsidiaries and affiliated companies. Cash investments of $59 million primarily relate to increased ownership in a chemical plant in Singapore and transportation and processing facilities which support the company's Point Arguello development. The company also made noncash investments of $43 million in two coal joint ventures.

The company's proved reserves of crude oil, natural gas and natural gas liquids increased 4, 4 and 2 percent, respectively. Revision of previous estimates, enhanced recovery programs and new discoveries enabled the company to more than replace its 1988 production.

Over the past three years, Phillips has charged against income a total of $1.1 billion relating principally to its worldwide exploration for petroleum reserves. A comparison of the components of exploration expense is shown below.

	Millions of Dollars		
	1988	1987	1986
Geological and geophysical	**$105**	130	135
Leasehold impairment	**161**	196	193
Dry holes	**41**	31	120
Lease rentals	**9**	9	11
	$316	366	459

The company's major net income exposures to foreign currency movements are due to its foreign deferred tax liabilities. Changes in the value of the dollar against certain foreign currencies can result in sizable fluctuations in net income because FASB Statement No. 52, "Foreign Currency Translation," requires foreign deferred taxes to be valued at current exchange rates. The company does not hedge these exposures because gains and losses on foreign deferred taxes do not impact cash flow. The company hedges, where feasible and appropriate, foreign exchange exposures which impact cash flow.

CHANGING PRICES AND THE EFFECT OF INFLATION

Market conditions continue to be the primary factor

in determining the prices and costs of company products. Inflation has not had a significant effect on other aspects of the company's operations.

OUTLOOK

Looking forward to 1989, a major uncertainty remains the price of oil and gas. An environment of fluctuating oil and gas prices requires constant reassessment of spending plans on long-term projects. The company has budgeted $975 million in 1989 for capital expenditures and investments. About half of the planned expenditures will be directed toward upstream projects, while nearly 40 percent will be devoted to the company's downstream businesses.

Major capital expenditures for upstream projects will include enhanced recovery projects in the Norwegian North Sea, development projects in the U.K. North Sea and offshore Indonesia, domestic development programs which are currently under way and additional gas well connections to existing gathering systems. Downstream capital expenditures and investments will include modernizing Phillips retail marketing outlets, construction of a hazardous waste incinerator at the Sweeny, Texas, refinery and increasing production capacities for ethylene, propylene, polyethylene and K-Resin polymer. At year-end 1988, Chemicals had four major expansions announced or in progress, including plans for construction of a new ethylene plant at the Sweeny Refinery and Petrochemical Complex. The company is attempting to arrange for the ethylene plant to be owned by a partnership in which the company would hold a 50 percent interest. The partnership anticipates using nonrecourse financing for the project.

A local California agency has voted to deny the authorization necessary to begin crude oil and natural gas production from the Point Arguello field offshore California. Appropriate steps to appeal this decision are being taken. Because of the regulatory action in California, the company expects worldwide crude oil and natural gas production to be slightly below the 1988 level for the next two years, based on other development projects under way or planned. This assumes no major changes in market conditions or no additional government-mandated curtailments in production.

In order to accelerate and expand its domestic exploration program, the company is negotiating with several foreign participants for a drilling joint venture. Instead of the traditional method of "farming out" individual prospects, the company has identified a major group of its domestic onshore and offshore prospects which could be drilled over a 3-year period. The foreign participants would pay substantially all the exploration costs for which they would earn approximately 50 percent of the company's interest in any oil and gas reserves discovered.

In February 1989, the company announced that it will redeem on March 15, 1989, all its outstanding Floating Rate Senior Notes Due 1995—approximately $440 million. The redemption will be funded primarily using existing cash balances. The company also announced that it would withdraw its convertible subordinated debenture registration statement which had been filed with the Securities and Exchange Commission on September 17, 1987.

Reinstatement of investment-grade ratings for debt and improved results of operations have broadened the company's financing alternatives. However, maintenance of cash and cash equivalents in excess of operating needs continues due to the volatility of oil and gas prices. The company's financial goals for the next few years include reducing total debt to approximately $4 billion, and building equity to $3 billion. To meet anticipated liquidity requirements and to achieve the debt reduction goal, the company will look primarily to cash flows from operations and to existing cash balances.

QUARTERLY COMMON STOCK PRICES AND CASH DIVIDENDS PER SHARE

	Stock Price		Dividends
	High	Low	
1988			
First	**$18¼**	**12⅛**	**.15**
Second	**18¾**	**15⅜**	**.15**
Third	**19¾**	**15⅝**	**.18**
Fourth	**22⅜**	**18**	**.18**
1987			
First	16¼	11¾	.15
Second	17⅛	13⅜	.15
Third	18¾	15⅝	.15
Fourth	17¼	10	.15
Closing Stock Price at December 31, 1988			**$19½**
Number of Stockholders of Record at January 31, 1989			**96,158**

Phillips common stock is traded on the New York, Pacific and Toronto stock exchanges.

SELECTED FINANCIAL DATA

	Millions of Dollars Except Per Share Amounts				
	1988	1987	1986	1985	1984
Sales and other operating revenues	**$11,304**	10,721	9,788	15,676	15,537
Net income	**650**	35	228	418	810
Net income per common share	**2.72**	.06	.89	1.44	1.75
Total assets	**11,968**	12,111	12,403	14,052	16,965
Long-term debt	**4,761**	5,419	5,758	6,548	2,840
Redeemable preferred stock	**—**	205	270	281	—
Cash dividends declared per share					
Common	**.66**	.60	.70	.95	.78
Preferred	**1.34**	1.73	2.02	1.04	—

See Management's Discussion and Analysis for discussion of factors that would enhance an understanding of these financial data.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
Phillips Petroleum Company

We have audited the accompanying consolidated balance sheets of Phillips Petroleum Company as of December 31, 1988 and 1987, and the related consolidated statements of income, changes in common stockholders' equity and cash flows for each of the three years in the period ended December 31, 1988. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Phillips Petroleum Company at December 31, 1988 and 1987, and the consolidated results of operations and cash flows for each of the three years in the period ended December 31, 1988 in conformity with generally accepted accounting principles.

Arthur Young & Company

Tulsa, Oklahoma
February 15, 1989

CONSOLIDATED STATEMENT OF INCOME

PHILLIPS PETROLEUM COMPANY

Years Ended December 31	Millions of Dollars		
	1988	1987	1986
Revenues			
Sales and other operating revenues	**$11,304**	10,721	9,788
Equity in earnings of affiliated companies	**32**	86	64
Other revenues	**154**	110	166
Total Revenues	**11,490**	10,917	10,018
Costs and Expenses			
Purchased crude oil and products	**6,176**	6,221	5,313
Production and operating expenses	**1,678**	1,783	1,628
Exploration expenses	**316**	366	459
Selling, general and administrative expenses	**439**	370	308
Depreciation, depletion, amortization and retirements	**868**	922	1,096
Taxes other than income taxes	**210**	217	210
Interest and expense on indebtedness	**688**	729	685
Unusual items	**—**	43	(355)
Total Costs and Expenses	**10,375**	10,651	9,344
Income before income taxes	**1,115**	266	674
Provision for income taxes	**465**	231	446
Net Income	**$ 650**	35	228
Net Income Applicable to Common Stock	**$ 639**	13	202
Net Income Per Share of Common Stock	**$ 2.72**	.06	.89
Average Common Shares Outstanding (in thousands)	**234,984**	228,326	227,546

See accounting policies and notes to financial statements.

CONSOLIDATED BALANCE SHEET

At December 31	Millions of Dollars	
	1988	1987
Assets		
Current Assets		
Cash and cash equivalents	**$ 1,079**	1,006
Accounts and notes receivable (less allowances: 1988—$17; 1987—$14)	**1,261**	1,269
Inventories	**562**	543
Prepaid expenses and other current assets	**160**	67
Total Current Assets	**3,062**	2,885
Investments and long-term receivables	**429**	377
Properties, plants and equipment (net)	**8,417**	8,772
Deferred charges	**60**	77
Total	**$11,968**	12,111
Liabilities		
Current Liabilities		
Accounts and notes payable	**$ 1,006**	1,016
Long-term debt due within one year	**133**	178
Accrued income and other taxes	**1,108**	929
Other accruals	**221**	279
Total Current Liabilities	**2,468**	2,402
Long-term debt	**4,761**	5,419
Accrued dismantlement, removal and restoration costs	**323**	303
Deferred income taxes	**1,874**	1,705
Other liabilities and deferred credits	**429**	460
Total Liabilities	**9,855**	10,289
Redeemable Preferred Stock		
Series A Adjustable Rate ($1.00 par value)		
Shares issued and outstanding (1987—8,481,795)	**—**	205
Common Stockholders' Equity		
Common stock—500,000,000 shares authorized at $1.25 par value		
Issued (1988—263,021,219 shares; 1987—248,684,301 shares)		
Par value	**329**	311
Capital in excess of par	**470**	224
Treasury stock (at cost: 1988—19,768,208 shares; 1987—20,333,852 shares)	**(1,198)**	(1,238)
Foreign currency translation adjustments	**(24)**	(31)
Guarantees for Long-Term Stock Savings Plan (LTSSP)	**(250)**	—
Earnings employed in the business	**2,786**	2,351
Total Common Stockholders' Equity	**2,113**	1,617
Total	**$11,968**	12,111

See accounting policies and notes to financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

PHILLIPS PETROLEUM COMPANY

Years Ended December 31	Millions of Dollars		
	1988	1987	1986
Cash Flows from Operating Activities			
Net income	**$ 650**	35	228
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, depletion, amortization and retirements	**868**	922	1,096
Dry hole costs and leasehold impairment	**202**	227	313
Deferred taxes	**170**	18	(214)
Decrease (increase) in accounts and notes receivable	**8**	(222)	601
Decrease (increase) in inventories	**(19)**	(36)	137
Decrease (increase) in prepaid expenses and other current assets	**(93)**	40	75
Increase (decrease) in accounts and notes payable	**(10)**	92	(414)
Increase (decrease) in taxes and other accruals	**121**	80	(417)
Other	**(32)**	6	(100)
Net cash provided by operating activities	**1,865**	1,162	1,305
Cash Flows from Investing Activities			
Capital expenditures, including dry hole costs	**(797)**	(737)	(646)
Property dispositions	**127**	30	633
Investment purchases	**(59)**	(35)	(23)
Investment sales	**19**	1	190
Net cash provided by (used for) investing activities	**(710)**	(741)	154
Cash Flows from Financing Activities			
Repayment of notes payable	**—**	—	(24)
Issuance of long-term debt	**687**	—	11
Repayment of long-term debt	**(1,638)**	(331)	(783)
Purchase of company stock	**(215)**	(69)	(15)
Issuance of company stock	**252**	—	—
Dividends paid	**(168)**	(156)	(183)
Net cash used for financing activities	**(1,082)**	(556)	(994)
Increase (Decrease) in Cash and Cash Equivalents	**73**	(135)	465
Cash and cash equivalents at beginning of year	**1,006**	1,141	676
Cash and cash equivalents at end of year	**$1,079**	1,006	1,141

See accounting policies and notes to financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN COMMON STOCKHOLDERS' EQUITY

	Shares of Common Stock		Millions of Dollars					
			Common Stock			Foreign Currency		
	Issued	Held in Treasury	Par Value	Capital in Excess of Par	Treasury Stock	Translation Adjustments	Guarantees for LTSSP	Earnings Employed in the Business
December 31, 1985	248,684,301	21,543,631	$311	213	(1,313)	(74)	—	2,507
Net income								228
Cash dividends declared and paid Common								(159)
Preferred								(24)
Issued under incentive compensation plans		(1,192,029)		11	72			(70)
Current period translation adjustment						15		
Translation adjustment recognized upon disposal of foreign investments						10		
Accretion of discount on preferred stock								(3)
December 31, 1986	248,684,301	20,351,602	311	224	(1,241)	(49)	—	2,479
Net income								35
Cash dividends declared and paid Common								(137)
Preferred								(19)
Issued under incentive compensation plans		(17,750)			3			(4)
Current period translation adjustment						18		
Accretion of discount on preferred stock								(3)
December 31, 1987	248,684,301	20,333,852	311	224	(1,238)	(31)	—	2,351
Net income								650
Cash dividends declared and paid Common								(157)
Preferred								(11)
Issued under incentive compensation plans		(566,094)		12	40			(42)
Sold to LTSSP	14,336,918		18	232			(250)	
Current period translation adjustment						(2)		
Translation adjustment recognized upon disposal of foreign investments						9		
Accretion of discount on preferred stock and other		450		2				(5)
December 31, 1988	**263,021,219**	**19,768,208**	**$329**	**470**	**(1,198)**	**(24)**	**(250)**	**2,786**

See accounting policies and notes to financial statements.

■ **Consolidation Principles and Investments**—All significant, majority-owned subsidiaries are consolidated. Investments in companies owned 20 to 50 percent, corporate joint ventures and other companies (affiliates) are accounted for using the equity method or cost, as appropriate.

■ **Statement of Cash Flows**—In 1988, the company adopted FASB Statement No. 95, "Statement of Cash Flows." The Consolidated Statement of Cash Flows replaces the Consolidated Statement of Changes in Financial Position. Prior years have been restated to conform to the new presentation. The new statement discloses net cash provided by or used for the company's operating, investing and financing activities.

■ **Cash Equivalents**—Cash equivalents are highly liquid short-term investments which are readily convertible to known amounts of cash and generally have original maturities within three months or less from their date of purchase.

■ **Inventories**—Crude oil, products and merchandise are valued at cost, which is lower than market in the aggregate, mainly on the last-in, first-out (LIFO) basis. Materials and supplies are valued at or below average cost.

■ **Oil and Gas Exploration and Development**—Oil and gas exploration and development costs are accounted for using the successful efforts method of accounting.

Property Acquisition Costs—Oil and gas leasehold acquisition costs are capitalized. Leasehold impairment is recognized based upon unsuccessful exploratory experience. Upon discovery of commercial reserves, leasehold costs are transferred to producing properties.

Exploratory Costs—Geological and geophysical expenses and the costs of carrying and retaining undeveloped properties are charged against income as incurred. Exploratory drilling costs are capitalized when incurred. If exploratory wells are determined to be commercially unsuccessful or dry holes, applicable costs are expensed.

Development Costs—Costs incurred to drill and equip development wells, including unsuccessful development wells, are capitalized.

Depletion and Amortization—Leasehold costs of producing properties are depleted using the unit-of-production method based on estimated proved oil and gas reserves. Amortization of intangible development costs is based on the unit-of-production method using the estimated proved developed oil and gas reserves.

■ **Depreciation and Amortization**—Depreciation and amortization of properties, plants and equipment, including assets under capital leases, are determined by the group straight-line method, the individual unit straight-line method or the unit-of-production method, applying the method considered most appropriate for each type of property.

■ **Property Dispositions**—When complete units of depreciable property are retired or sold, the asset cost and related accumulated depreciation are eliminated with any gain or loss reflected in income. When less than complete units of depreciable property are disposed of or retired, the difference between asset cost and salvage value is charged or credited to accumulated depreciation.

■ **Maintenance and Repairs**—Maintenance and repair costs are expensed as incurred. Significant improvements are capitalized.

■ **Dismantlement, Removal and Restoration Costs**—The estimated costs, net of salvage values, of dismantling and removing major facilities, including necessary site restoration, are accrued using either the unit-of-production or the straight-line method.

■ **Foreign Currency Translation**—The U.S. dollar is the functional currency for most of the company's operations. Adjustments resulting from the process of translating foreign functional currency financial statements into U.S. dollars are accumulated as a separate component of common stockholders' equity. Foreign currency transaction gains and losses are included in current earnings.

■ **Income Taxes**—Deferred taxes are provided for all significant timing differences in the recognition of revenues and expenses for tax and financial purposes. Allowable tax credits are applied currently as reductions of the provision for income taxes. No provision for U.S. income taxes is made on undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds.

■ **Income Per Share of Common Stock**—Income per share of common stock is determined after deducting the dividend requirements of preferred stock and the accretion of the excess of redemption value of preferred stock over its carrying value. The calculation is based upon the daily weighted average number of common shares outstanding during the period.

Note 1—Inventories

Inventories at December 31 consisted of the following:

	Millions of Dollars	
	1988	1987
Crude oil, products and merchandise	**$455**	433
Materials and supplies	**107**	110
	$562	543

Inventories valued on a LIFO basis totaled $396 and $371 million at December 31, 1988 and 1987, respectively, and would have been approximately $326 and $353 million higher, respectively, had they been valued using the first-in, first-out (FIFO) method.

Note 2—Investments and Long-Term Receivables

Components of investments and long-term receivables at December 31 were as follows:

	Millions of Dollars	
	1988	1987
Investments in and advances to affiliated companies	**$204**	203
Long-term receivables	**52**	58
Other investments	**173**	116
	$429	377

Earnings employed in the business at December 31, 1988, included $111 million relating to undistributed earnings of affiliated companies. Dividends received from affiliated companies were $41, $58 and $184 million in 1988, 1987 and 1986, respectively.

Note 3—Properties, Plants and Equipment

The company's investment in properties, plants and equipment (at cost) at December 31 is summarized as follows:

	Millions of Dollars	
	1988	1987
Exploration and Production	**$ 8,851**	8,886
Gas and Gas Liquids	**2,016**	2,055
Petroleum Products	**3,162**	2,992
Chemicals	**1,529**	1,406
Corporate and Other	**1,007**	1,136
	16,565	16,475
Accumulated depreciation, depletion and amortization	**8,148**	7,703
	$ 8,417	8,772

Note 4—Debt

Long-Term

Long-term debt due after one year at December 31 consisted of the following:

	Millions of Dollars	
	1988	1987
Floating Rate Senior Notes Due 1995	**$ 440**	1,573
14¾% Subordinated Debentures Due 2000	**1,047**	1,089
13⅞% Senior Notes Due 1997	**1,299**	1,299
12⅞% Notes Due September 1, 1992	**187**	187
12¼% Debentures Due 2012	**288**	294
11¼% Debentures Due 2013	**223**	227
8⅞% Debentures Due 2000	**103**	123
7⅝% Debentures Due 2001	**69**	76
5⅝% Marine Terminal Revenue Bonds, Series 1977 Due 2007	**20**	20
Notes payable to banks, insurance companies and others due through 1995 at 7½% - 9⅞%	**503**	351
Production payment	**103**	171
Guarantees of LTSSP notes payable	**225**	—
Commercial paper	**248**	—
Other obligations	**6**	9
	$4,761	5,419

Interest rates on variable rate debt at December 31 were as follows:

	1988	1987
Floating Rate Senior Notes Due 1995	**10.94%**	9.75
Production payment	**9.44**	8.31
LTSSP notes payable	**7.95**	—
Commercial paper	**9.13**	—

Maturities of long-term debt in 1989 through 1993 are: $133 (included in current liabilities), $110, $562, $286 and $369 million, respectively.

In 1988, the company entered into a $250 million Commercial Paper Program supported by a direct-pay irrevocable letter of credit through September 1991. The LTSSP notes payable are supported by irrevocable letters of credit through July 1991. The commercial paper and LTSSP notes payable have been classified as noncurrent based upon the company's ability and intent to refinance them on a long-term basis.

Each bank providing an irrevocable letter of credit for the LTSSP notes and the Commercial Paper Program has the optional right if the current directors or their approved successors cease to be a majority of the Board, and upon not less than 90 days' notice, to terminate its obligation under the agreements pertaining to the letters of credit.

Line of Credit
In 1988, the company arranged a 7-year $200 million bank revolving line of credit which will expire August 1995. At December 31, 1988, the balance outstanding was $200 million at an interest rate of 9.31 percent. Included in the agreement is a similar optional early termination provision like that described in the preceding paragraph.

Long-Term Stock Savings Plan Loan Guarantees
In 1988, the LTSSP borrowed $250 million to purchase 14,336,918 shares of authorized but previously unissued common stock from the company at $17.4375 per share. Since the company has effectively guaranteed the LTSSP's borrowings, the unpaid balance is reported as a liability of the company and a corresponding amount, akin to unearned compensation, is shown as a reduction of common stockholders' equity. Both the liability and the amount in stockholders' equity will be reduced in equal amounts as the LTSSP repays the borrowings. The LTSSP will repay the loans (plus interest) over a 10-year period using company contributions and dividends received on the shares of common stock that have not been allocated to plan participants.

Compensating Balances
The company maintains compensating balances for banking services under various arrangements with several banks. The compensating balances are not legally restricted as to withdrawal and are continually reviewed and adjusted based on levels of services and activity. The total of all compensating balances is not material in relation to total liquid assets.

Note 5—Non-Mineral Operating Leases
The company leases service stations, computers and other facilities and equipment. At December 31, 1988, future minimum payments due under noncancelable operating leases were as follows:

	Millions of Dollars
1989	$ 37
1990	27
1991	20
1992	13
1993	11
Remaining years	72
Total payments	$180

Operating lease rental expense for the years ended December 31 was as follows:

	Millions of Dollars		
	1988	1987	1986
Total rentals	**$83**	84	94
Less sublease rentals	**6**	6	9
Net rentals	**$77**	78	85

Note 6—Redeemable Preferred Stock
On August 15, 1988, the company redeemed for $212 million all the outstanding shares of the Series A preferred stock at the mandatory redemption value of $25 per share.

The company purchased and retired 2,859,665 and 619,739 shares of the Series A preferred stock at a cost of $69 and $15 million, respectively, during 1987 and 1986.

Note 7—Preferred Share Purchase Rights
At December 31, 1988, there were 243,253,011 Preferred Share Purchase Rights (Rights) outstanding. The Rights are not exercisable or transferable, apart from the company's common stock, until after a person or group acquires, or has the right to acquire, beneficial ownership of 20 percent or more of the company's common stock or announces a tender or exchange offer for 30 percent or more of the company's common stock. Each Right entitles the holder to purchase one one-hundredth of a share of a new series of preferred stock for $35 and contains anti-dilution provisions that entitle the holder, in the event of specific transactions, to purchase common stock of the surviving corporation at one-half of market price as determined under the terms of the Rights Agreement. The Rights will expire on July 10, 1993, unless previously redeemed at the option of the company for 8⅓ cents per Right or exercised.

Note 8—Other Contingent Liabilities
In addition to amounts recorded at December 31, 1988 and 1987, the company was contingently liable for $23 million for obligations of affiliated companies and others. Also, the company had contingent liabilities at both dates resulting from throughput agreements with pipeline and processing companies in which it holds stock interests. Under these agreements, Phillips may be required to provide any such company with additional funds through advances against future charges for the shipping or processing of petroleum liquids, natural gas and refined products.

The company is a party to a number of legal proceedings pending in various courts or agencies in which it or a subsidiary appears as plaintiff or defendant for which no provision has been made. While it is not possible at this time to establish the ultimate amount of liability with respect to contingent liabilities, including those related to legal proceedings, the company is of the opinion that the aggregate amount of any such liabilities for which provision has not been made will not have a material adverse effect on its financial position.

Note 9—Incentive Compensation Plans

The company has two incentive compensation plans that provide awards to key employees. These plans are the Incentive Compensation Plan and the 1986 Stock Plan. In anticipation of awards that may become payable under the plans, provisions of $25, $5 and $10 million have been charged against earnings in 1988, 1987 and 1986, respectively.

The 1986 Stock Plan, which includes the Stock Option Plan and the Strategic Incentive Plan, is in effect for the 5-year period beginning January 1, 1986, through December 31, 1990. The maximum number of shares of the company's common stock that may be used to satisfy the 1986 Stock Plan's obligations for the 5-year period, subject to stock splits, stock dividends and other similar actions, is approximately 8 million shares.

Stock options granted under provisions of the Stock Option Plan permit the purchase of shares of the company's common stock at exercise prices equivalent to the average market price of the stock on the date the options were granted. The options have a term of 10 years and normally become exercisable in increments up to 25 percent on each anniversary date following the date of grant. Stock Appreciation Rights (SARs) may from time to time be affixed to the options. Options exercised in the form of SARs permit the holder to receive stock or a combination of cash and stock equivalent to the excess of the average market price on the exercise date over the exercise price.

During 1988, the company granted options for 1,735,311 shares of stock; options for 329,432 shares were forfeited and options for 146,233 shares were exercised at prices ranging from $12.63 to $16.63 per share. At December 31, 1988, 3,694,918 shares were under option (including 1,038,258 with SARs) at exercise prices ranging from $12.63 to $17.75. Options for 460,683 shares were exercisable.

Note 10—Retirement Income Plans

The company has defined benefit retirement plans covering substantially all employees. The company's principal retirement plan is noncontributory and benefits are based on an employee's years of service and average earnings for the three highest consecutive calendar years of compensation during the 10 years immediately preceding retirement. Plans of subsidiaries that have not adopted the company's principal retirement plan are generally noncontributory with benefit formulas based on employee earnings, credited service or both. The company's funding policy for U.S. plans is to contribute the minimum required by the Employee Retirement Income Security Act of 1974. The company also sponsors nonqualified supplementary retirement plans for senior management and nonemployee directors.

Through 1988, contributions to foreign plans were expensed when paid. Adoption of FASB Statement No. 87, "Employers' Accounting for Pensions," for foreign plans effective January 1, 1989, will not significantly affect the company's results of operations or financial position.

Pension cost (income) was as follows:

	Millions of Dollars		
	1988	1987	1986
U.S. Plans			
Service cost—benefits earned during the period	**$17**	17	23
Interest cost on projected benefit obligation	**19**	16	64
Return on assets			
Actual	**(35)**	(10)	(158)
Deferred gains (losses)	**16**	(5)	64
Amortization of			
Net asset	**(7)**	(7)	(18)
Unrecognized net (gains) losses	**—**	—	(7)
Net pension cost (income) for U.S. plans	**10**	11	(32)
Foreign Plans	**4**	7	8
Net pension cost (income)	**$14**	18	(24)
Assumptions Used for U.S. Plans—at December 31			
Rate of increase in compensation levels	**6.50%**	6.25	6.25
Discount rate	**9.75**	10.00	9.25
Long-term rate of return on assets	**11.25**	11.00	9.25

In determining net pension cost, the company has elected to amortize unrecognized net gains and losses on a straight-line basis over 10 years. The $42 million increase in pension cost for 1987 is primarily a result of the restructuring on September 1, 1986, of the company's principal retirement plan, partially offset by a lower service cost due to 1986 work force reductions. The restructuring settled the company's obligation for benefits accrued through September 1, 1986.

All of the company's funded U.S. plans have assets in excess of the accumulated benefit obligation. Assets include a participation right to an annuity contract, real estate, commingled funds and a separate account with an insurance company. The following table presents the funded status of the plans and a reconciliation with accrued pension cost and deferred gain on reversion at December 31.

	Millions of Dollars	
	1988	1987
Plan assets at fair value	**$ 205**	171
Actuarial present value of benefit obligations		
Vested benefits	**42**	41
Nonvested benefits	**2**	1
Accumulated benefit obligation	**44**	42
Effect of projected future salary increases	**160**	138
Projected benefit obligation	**204**	180
Excess assets (obligation)	**1**	(9)
Unrecognized net gains	**(22)**	(12)
Unrecognized net asset	**(82)**	(89)
Accrued pension cost and deferred gain on reversion	**$(103)**	(110)

Accrued pension cost and deferred gain on reversion is reflected in the balance sheet as follows:

	Millions of Dollars	
	1988	1987
Deferred charges	**$ 5**	6
Other accruals	**(1)**	(18)
Other liabilities and deferred credits	**(107)**	(98)
	$(103)	(110)

Note 11—Unusual Items

Unusual items consisted of the following for the years ended December 31:

	Millions of Dollars	
	1987	1986
Special separation and reorganization programs	$(50)	(114)
Retirement plan restructuring	—	275
Asset disposition program	—	212
Minerals operations*	7	(18)
Increase (decrease) in pretax earnings	$(43)	355

** Previously reported as loss on disposal of discontinued operations.*

Unusual items decreased net income $26 million in 1987, and increased net income $226 million in 1986.

Note 12—Taxes

Taxes charged to income were as follows:

	Millions of Dollars		
	1988	1987	1986
Taxes Other Than Income Taxes			
Property	**$ 66**	76	78
Crude oil excise	**—**	—	13
Production	**61**	65	57
Payroll	**48**	44	41
Environmental	**19**	17	—
Other	**16**	15	21
	210	217	210
Income Taxes			
Federal			
Current	**77**	23	193
Deferred	**87**	(142)	(174)
Foreign			
Current	**314**	181	429
Deferred	**(36)**	151	(19)
State and local (current)	**23**	18	17
	465	231	446
Total taxes charged to income	**$675**	448	656

Deferred income taxes related to timing differences were:

	Millions of Dollars		
	1988	1987	1986
Depreciation	**$ 2**	138	116
Intangible drilling and certain other costs	**(15)**	(29)	(47)
Dismantlement provision	**(9)**	(16)	(16)
Leasehold impairment	**58**	(6)	(37)
Asset dispositions	**(9)**	3	(95)
Contingencies and accruals	**17**	(54)	(17)
Employee benefit plans	**13**	(18)	(92)
Interest rate swap agreements	**3**	(20)	—
Inventories	**(1)**	12	(5)
Other	**(8)**	(1)	—
	$ 51	9	(193)

Deferred taxes have not been provided for the company's equity in undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds. At December 31, 1988, 1987 and 1986, the aggregate of these funds was $267, $298 and $311 million, respectively, excluding amounts which, if remitted, would be expected to result in little or no tax because of available tax credits and other deductions.

The amounts of U.S. and outside U.S. income before income taxes and a reconciliation of tax at the federal statutory rate with the provision for income taxes follow:

	Millions of Dollars			Percent of Pretax Income		
	1988	1987	1986	**1988**	1987	1986
Income (loss) before income taxes						
United States	**$ 518**	(305)	(78)	**46.5%**	(114.7)	(11.6)
Outside United States	**597**	571	752	**53.5**	214.7	111.6
	$1,115	266	674	**100.0%**	100.0	100.0
Federal statutory income tax	**$ 379**	106	310	**34.0%**	40.0	46.0
Foreign taxes in excess of federal statutory rate	**80**	144	143	**7.2**	54.1	21.2
Income taxed at capital gain rate	**—**	—	(17)	**—**	—	(2.5)
Possession tax credit	**(19)**	(19)	(13)	**(1.7)**	(7.1)	(1.9)
Acquisition adjustments	**—**	(16)	—	**—**	(6.0)	—
State income taxes—net of federal benefit	**15**	11	9	**1.3**	4.1	1.4
Amortization of excess cost	**3**	6	7	**.3**	2.2	1.0
Other	**7**	(1)	7	**.6**	(.4)	1.0
	$ 465	231	446	**41.7%**	86.9	66.2

Excise taxes collected on the sale of petroleum products and paid to taxing agencies were $499, $206 and $168 million for the years ended December 31, 1988, 1987 and 1986, respectively. These taxes are excluded from reported revenues.

All deficiencies related to the examination of the company's U.S. income tax returns by the Internal Revenue Service have been settled through 1974. The company is of the opinion that any unsettled deficiencies for subsequent years will not have a material effect on the financial position of the company.

The company has not adopted FASB Statement No. 96, "Accounting for Income Taxes," which was issued in December 1987. FASB Statement No. 100, "Accounting for Income Taxes—Deferral of the Effective Date of FASB Statement No. 96," defers the mandatory adoption date for Statement No. 96 for one year; i.e., for fiscal years beginning after December 15, 1989. The company will not decide when it intends to adopt Statement No. 96 until it has had an opportunity to analyze a special report announced by the FASB. The special report will deal with implementation issues caused by Statement No. 96 and it is expected to be published during the first quarter of 1989. If the company were to adopt Statement No. 96 effective January 1, 1989, as originally promulgated, the one-time benefit to net income resulting from the cumulative effect of a change in accounting principle would approximate $150 million.

Note 13—Other Financial Information

	Millions of Dollars Except Per Share Amounts		
	1988	1987	1986
Interest			
Incurred			
Debt	**$637**	666	738
Other	**83**	122	3
	720	788	741
Capitalized	**(32)**	(59)	(56)
Interest expense	**$688**	729	685
Maintenance and repairs—expensed*	**$435**	499	372
Research and development expenditures—expensed	**$101**	94	89
Foreign currency transaction gains (losses)—after-tax	**$ 29**	(42)	87
Noncash financing and investing activities			
Guarantees of LTSSP borrowings	**$250**	—	—
Investment in joint ventures in exchange for noncash assets	**43**	—	—
Cash payments			
Interest	**$681**	680	975
Income taxes	**284**	344	839
Cash dividends declared and paid per share			
Common	**$ .66**	.60	.70
Preferred	**1.34**	1.73	2.02

** Includes expenses of $150 and $32 million in 1987 and 1986, respectively, to elevate six platforms offshore Norway and expenses in 1988 of $41 million to construct a concrete wave barrier to protect a facility offshore Norway.*

Note 14—Segment and Geographic Information

The company is involved primarily in Petroleum and Chemicals operations. Petroleum operations are fully integrated and involve the exploration, production, processing, transportation and refining of crude oil and natural gas, together with the subsequent transportation and marketing of products derived therefrom. This segment also provides feedstock for the production of petrochemicals. Chemicals operations involve the manufacture and marketing of a broad range of petroleum-based chemical products. Minerals and various other operations are included in Other.

Sales and other operating revenues to outside customers and sales within Phillips by business segment and by geographic area are at market value. Operating profit excludes general corporate revenue and expense, interest, unusual items, minority interest and income taxes. The company's share of earnings of affiliated companies has been included with the segment and geographic area in which the affiliate operates. Intersegment and intergeographic sales are eliminated in determining consolidated revenue. Corporate assets are principally cash.

Analysis of Results by Business Segment

Years Ended December 31	Millions of Dollars		
	1988	1987	1986
Sales and Other Operating Revenues to Outside Customers			
Petroleum			
Exploration and production	**$ 1,224**	1,187	1,284
Gas and gas liquids	**785**	767	811
Refining, marketing and transportation	**6,763**	6,809	5,955
	8,772	8,763	8,050
Chemicals	**2,518**	1,928	1,698
Other	**14**	30	40
	$11,304	10,721	9,788
Sales within Phillips			
Petroleum			
Exploration and production	**$ 1,019**	1,111	1,108
Gas and gas liquids	**564**	611	671
Refining, marketing and transportation	**544**	477	461
Eliminations (intrasegment)	**(1,603)**	(1,743)	(1,796)
	524	456	444
Chemicals	**180**	161	161
Other	**80**	19	26
	$ 784	636	631
Summary of Net Income			
Operating Profit			
Petroleum			
Exploration and production	**$ 526**	381	255
Gas and gas liquids	**15**	39	(8)
Refining, marketing and transportation	**471**	201	458
	1,012	621	705
Chemicals	**911**	482	299
Other	**46**	(12)	(17)
Total operating profit	**1,969**	1,091	987
Other revenues	**35**	131	151
Nonoperating items	**(1,354)**	(1,187)	(910)
	$ 650	35	228

Years Ended December 31	Millions of Dollars		
	1988	1987	1986
Total Assets			
Petroleum			
Exploration and production	**$ 4,729**	5,192	5,601
Gas and gas liquids	**1,144**	1,236	1,289
Refining, marketing and transportation	**2,707**	2,643	2,500
	8,580	9,071	9,390
Chemicals	**1,349**	1,165	1,053
Corporate and Other	**2,039**	1,875	1,960
	$11,968	12,111	12,403
Depreciation, Depletion, Amortization and Retirements			
Petroleum			
Exploration and production	**$ 552**	600	781
Gas and gas liquids	**110**	113	110
Refining, marketing and transportation	**102**	113	108
	764	826	999
Chemicals	**57**	63	66
Corporate and Other	**47**	33	31
	$ 868	922	1,096
Capital Expenditures— Properties, Plants and Equipment			
Petroleum			
Exploration and production	**$ 377**	391	339
Gas and gas liquids	**37**	43	86
Refining, marketing and transportation	**177**	131	75
	591	565	500
Chemicals	**130**	78	46
Corporate and Other	**76**	94	100
	$ 797	737	646

Analysis of Results by Geographic Area

Years Ended December 31	Millions of Dollars		
	1988	1987	1986
Sales and Other Operating Revenues to Outside Customers			
United States	**$ 9,673**	9,106	7,955
Norway	**548**	520	716
United Kingdom	**533**	614	651
Africa	**55**	57	43
Other areas	**495**	424	423
	$11,304	10,721	9,788
Sales within Phillips			
United States	**$ 195**	131	102
Norway	**199**	170	109
United Kingdom	**5**	4	6
Africa	**145**	181	161
Other areas	**48**	36	32
	$ 592	522	410

Analysis of Results by Geographic Area

Years Ended December 31	Millions of Dollars		
	1988	1987	1986
Operating Profit			
United States	**$ 1,400**	599	516
Norway	**343**	215	387
United Kingdom	**50**	90	57
Africa	**71**	122	(38)
Other areas	**105**	65	65
	$ 1,969	1,091	987
Total Assets			
United States	**$ 8,046**	8,306	8,619
Norway	**1,156**	1,143	1,071
United Kingdom	**388**	471	459
Africa	**222**	246	239
Other areas	**417**	367	353
Corporate	**1,739**	1,578	1,662
	$11,968	12,111	12,403
Export Sales	**$ 480**	424	415

SELECTED QUARTERLY FINANCIAL DATA

	Millions of Dollars			Net Income (Loss) Per Share of Common Stock
	Sales and Other Operating Revenues	Income before Income Taxes	Net Income (Loss)	
1988				
First	**$2,863**	**261**	**130**	**.55**
Second	**2,840**	**254**	**170**	**.72**
Third	**2,791**	**334**	**215**	**.89**
Fourth	**2,810**	**266**	**135**	**.55**
1987				
First	2,491	32	(32)	(.16)
Second	2,609	30	3	(.01)
Third	2,764	61	31	.11
Fourth	2,857	143	33	.12

Unusual items in 1987 decreased income before income taxes $43 million in the fourth quarter.

OIL AND GAS OPERATIONS

Statistics

Net Production	**1988**	1987	1986
	Thousands of Barrels Daily		
Crude Oil			
United States	**110**	113	124
Norway	**57**	46	52
United Kingdom	**19**	22	23
Africa	**25**	25	29
Other areas	**11**	12	10
	222	218	238
Natural Gas Liquids			
Norway	**12**	8	10
Natural Gas—Wet Basis	Millions of Cubic Feet Daily		
United States	**851**	772	820
Norway*	**259**	241	217
United Kingdom*	**47**	43	54
Other areas	**32**	30	29
	1,189	1,086	1,120

**Dry basis.*

Average Sales Prices	**1988**	1987	1986
Crude Oil—Per Barrel			
United States	**$13.41**	16.35	13.83
Norway	**14.98**	18.26	14.98
United Kingdom	**15.25**	18.38	15.09
Africa	**15.34**	18.10	14.04
Other areas	**11.29**	13.10	10.02
Outside United States	**14.77**	17.69	14.35
Worldwide	**14.11**	17.02	14.09
Natural Gas Liquids—Per Barrel			
Norway	**8.89**	8.50	14.11
Natural Gas (Lease)—Per Thousand Cubic Feet			
United States	**1.53**	1.45	1.64
Norway	**2.75**	3.10	4.72
United Kingdom	**2.40**	1.63	1.37
Other areas	**1.37**	1.27	1.38
Outside United States	**2.60**	2.77	3.87
Worldwide	**1.88**	1.88	2.30

Average Production (Lifting) Costs* —Per Equivalent Barrel of Oil			
United States	**$4.34**	4.86	4.88
Norway	**5.78**	10.69	7.07
United Kingdom	**2.60**	2.18	1.88
Africa	**4.50**	4.56	5.87
Other areas	**4.95**	4.53	4.12

**Production (lifting) costs consist of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. Also included is the U.S. crude oil excise tax of $13 million in 1986; expenses of $150 and $32 million in 1987 and 1986, respectively, to elevate six platforms offshore Norway; and expenses of $41 million in 1988 to construct a concrete wave barrier to protect a facility offshore Norway. It does not include depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.*

Acreage at December 31, 1988

	Thousands of Acres	
	Gross	Net
Developed		
United States	**2,312**	**1,483**
Norway	**45**	**17**
United Kingdom	**22**	**6**
Africa	**98**	**25**
Other areas	**400**	**112**
	2,877	**1,643**
Undeveloped		
United States	**4,569**	**3,156**
Norway	**960**	**264**
United Kingdom	**1,309**	**462**
Africa	**29,903**	**8,272**
Asia	**7,433**	**4,997**
Canada	**1,605**	**453**
Other areas	**1,479**	**372**
	47,258	**17,976**

Net Wells Completed*

	Productive			Dry		
	1988	1987	1986	**1988**	1987	1986
Exploratory						
United States	**7**	17	10	**12**	14	22
Norway	**	—	—	**—**	—	—
United Kingdom	**1**	—	—	**1**	—	1
Africa	**1**	**	—	**	—	1
Other areas	**8**	6	2	**7**	8	3
	17	23	12	**20**	22	27
Development						
United States	**138**	117	81	**12**	11	11
Norway	**4**	**	**	**—**	—	—
United Kingdom	**2**	—	1	**	—	—
Africa	**1**	1	—	**	—	—
Other areas	**14**	3	6	**2**	1	1
	159	121	88	**14**	12	12

**Excludes farmout arrangements.*
***Phillips total proportionate interest in wells completed during the year was less than one.*

Wells at Year-End 1988

	In Progress*		Productive**			
			Oil		Gas	
	Gross	Net	Gross	Net	Gross	Net
United States	**101**	**48**	**32,085**	**7,292**	**5,505**	**2,721**
Norway	**3**	**1**	**106**	**39**	**34**	**10**
United Kingdom	**29**	**7**	**12**	**4**	**39**	**7**
Africa	**2**	**1**	**189**	**46**	**10**	**2**
Other areas	**10**	**5**	**1,087**	**370**	**334**	**94**
	145	**62**	**33,479**	**7,751**	**5,922**	**2,834**

**Includes wells which have been temporarily suspended.*
***Includes 1,531 gross and 640 net multiple completion wells.*

Capitalized Costs

At December 31	Millions of Dollars	
	1988	1987
Proved properties	**$8,166**	8,047
Unproved properties	**685**	839
	8,851	8,886
Accumulated depreciation, depletion and amortization	**4,683**	4,340
	$4,168	4,546

- Capitalized costs include the cost of equipment and facilities that support only oil and gas producing activities. Not included are investments in U.S. natural gas liquids extraction plants and related systems, as well as downstream manufacturing, distribution and marketing facilities.
- Proved properties include capitalized costs for oil and gas leaseholds holding proved reserves, development wells and related equipment and facilities (including uncompleted development well costs) and support equipment.
- Unproved properties include capitalized costs for oil and gas leaseholds under exploration (including those where petroleum liquids and natural gas were found but not in sufficient quantities to be considered proved reserves) and uncompleted exploratory well costs, including those exploratory wells under evaluation.

Costs Incurred

	Millions of Dollars			
	Acquisition	Exploration	Development	Total
1988				
United States	**$10**	**101**	**181**	**292**
Norway	**—**	**11**	**75**	**86**
United Kingdom	**—**	**30**	**22**	**52**
Africa	**4**	**10**	**6**	**20**
Other areas	**4**	**19**	**14**	**37**
	$18	**171**	**298**	**487**
1987				
United States	$28	128	143	299
Norway	—	8	87	95
United Kingdom	—	28	17	45
Africa	—	8	8	16
Other areas	7	31	4	42
	$35	203	259	497
1986				
United States	$13	130	166	309
Norway	—	5	87	92
United Kingdom	—	24	5	29
Africa	2	6	9	17
Other areas	1	24	13	38
	$16	189	280	485

- Costs incurred include both capitalized and expensed items.
- Acquisition costs include the costs of acquiring undeveloped oil and gas leaseholds.
- Exploration costs include geological and geophysical expenses, the cost of retaining undeveloped leaseholds, and exploratory drilling costs.
- Development costs include the cost of drilling and equipping development wells and building related production facilities for extracting, treating, gathering and storing petroleum liquids and natural gas.

Proved Reserves Worldwide

Years Ended December 31	Crude Oil					
	Millions of Barrels					
	United States	Norway	United Kingdom	Africa	Other Areas	Total
Developed and Undeveloped						
End of 1985	466	264	36	94	41	901
Revisions of previous estimates	(27)	(25)	—	(1)	(9)	(62)
Improved recovery	1	—	—	—	—	1
Purchases of reserves in place	1	—	—	—	—	1
Extensions and discoveries	6	—	86	1	1	94
Production	(44)	(19)	(8)	(11)	(2)	(84)
Sales of reserves in place	(48)	—	(85)	—	—	(133)
End of 1986	355	220	29	83	31	718
Revisions of previous estimates	1	57	6	4	8	76
Improved recovery	4	—	—	—	1	5
Purchases of reserves in place	1	—	—	—	—	1
Extensions and discoveries	13	—	—	3	6	22
Production	(40)	(17)	(7)	(9)	(4)	(77)
Sales of reserves in place	(1)	—	—	—	—	(1)
End of 1987	333	260	28	81	42	744
Revisions of previous estimates	19	29	2	—	6	56
Improved recovery	7	38	—	—	2	47
Purchases of reserves in place	4	—	—	—	—	4
Extensions and discoveries	10	—	—	—	1	11
Production	(39)	(21)	(7)	(8)	(5)	(80)
Sales of reserves in place	(7)	—	—	—	—	(7)
End of 1988	**327**	**306**	**23**	**73**	**46**	**775**
Developed						
End of 1985	373	194	36	84	36	723
End of 1986	280	176	28	61	30	575
End of 1987	261	188	27	58	36	570
End of 1988	**265**	**214**	**23**	**50**	**40**	**592**

- Proved reserves are those quantities of crude oil, natural gas and natural gas liquids which, upon analysis of geological and engineering data, appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions. As additional information becomes available or conditions change, proved reserve estimates must be revised.

- Developed reserves are those portions of proved crude oil, natural gas and natural gas liquids reserves that are recoverable through existing well bores and production equipment and facilities.
- For 1986, extensions and discoveries and sales of reserves in place in the United Kingdom include 85 million barrels of crude oil reserves that were added and sold during the year.
- For 1988, 38 million barrels were added as a result of an expanded waterflood project in the Ekofisk field in the Norwegian North Sea.

Years Ended December 31	Natural Gas				
	Billions of Cubic Feet				
	United States	Norway	United Kingdom	Other Areas	Total
Developed and Undeveloped					
End of 1985	3,580	862	183	258	4,883
Revisions of previous estimates	(93)	542	(66)	29	412
Extensions and discoveries	67	—	357	5	429
Production	(283)	(91)	(17)	(10)	(401)
Sales of reserves in place	(39)	—	(140)	—	(179)
End of 1986	3,232	1,313	317	282	5,144
Revisions of previous estimates	267	132	(33)	5	371
Extensions and discoveries	159	—	7	19	185
Production	(281)	(97)	(16)	(13)	(407)
Sales of reserves in place	(8)	—	—	—	(8)
End of 1987	3,369	1,348	275	293	5,285
Revisions of previous estimates	145	304	19	(19)	449
Improved recovery	—	49	—	—	49
Purchases of reserves in place	7	—	—	—	7
Extensions and discoveries	166	—	—	11	177
Production	(312)	(105)	(18)	(13)	(448)
Sales of reserves in place	(10)	—	—	—	(10)
End of 1988	**3,365**	**1,596**	**276**	**272**	**5,509**
Developed					
End of 1985	3,292	825	177	209	4,503
End of 1986	3,020	1,252	74	202	4,548
End of 1987	3,091	1,286	68	221	4,666
End of 1988	**3,086**	**1,431**	**256**	**208**	**4,981**

- Natural gas production quantities may differ from quantities of gas production (delivered for sale) as reported on page 42, primarily because the quantities reported above exclude the gas equivalent of the liquids, where applicable, but include gas consumed at the lease.
- In 1985, Norway gas reserves were revised downward as the result of a gas-reinjection program to reduce the rate of subsidence in the Ekofisk field in the Norwegian North Sea. The 1986 upward revisions are the result of reducing the gas-reinjection program.
- For 1986, extensions and discoveries and sales of reserves in place in the United Kingdom include 140 billion cubic feet of natural gas reserves that were added and sold during the year.
- Natural gas reserves are computed at 14.65 pounds per square inch absolute and 60° Fahrenheit.

Years Ended December 31	Natural Gas Liquids			
	Millions of Barrels			
	United States	Norway	Other Areas	Total
Developed and Undeveloped				
End of 1985	110	51	1	162
Revisions of previous estimates	43	(5)	—	38
Extensions and discoveries	2	—	—	2
Production	(14)	(3)	—	(17)
End of 1986	141	43	1	185
Revisions of previous estimates	(6)	(1)	1	(6)
Production	(11)	(3)	—	(14)
End of 1987	124	39	2	165
Revisions of previous estimates	4	10	(1)	13
Improved recovery	—	2	—	2
Extensions and discoveries	4	—	—	4
Production	(11)	(4)	—	(15)
End of 1988	**121**	**47**	**1**	**169**
Developed				
End of 1985	109	51	1	161
End of 1986	141	41	1	183
End of 1987	123	37	2	162
End of 1988	**118**	**40**	**1**	**159**

Results of Operations

	Millions of Dollars					
	United States	Norway	United Kingdom	Africa	Other Areas	Total
1988						
Sales	**$ 521**	**316**	**148**	**27**	**61**	**1,073**
Transfers	**553**	**310**	**—**	**104**	**—**	**967**
Total revenues	**1,074**	**626**	**148**	**131**	**61**	**2,040**
Production (lifting) costs	**390**	**236**	**26**	**41**	**29**	**722**
Exploration expenses	**246**	**5**	**19**	**10**	**35**	**315**
Depreciation, depletion, amortization and retirements	**382**	**65**	**51**	**18**	**13**	**529**
	56	**320**	**52**	**62**	**(16)**	**474**
Provision for income taxes	**21**	**190**	**18**	**48**	**1**	**278**
Results of operations for producing activities	**$ 35**	**130**	**34**	**14**	**(17)**	**196**
1987						
Sales	$ 521	322	159	19	67	1,088
Transfers	597	291	15	152	5	1,060
Total revenues	1,118	613	174	171	72	2,148
Production (lifting) costs	419	367	23	43	28	880
Exploration expenses	294	5	22	5	35	361
Depreciation, depletion, amortization and retirements	445	49	53	14	17	578
	(40)	192	76	109	(8)	329
Provision for income taxes	(15)	116	27	82	1	211
Results of operations for producing activities	$ (25)	76	49	27	(9)	118
1986						
Sales	$ 571	414	130	3	49	1,167
Transfers	582	317	22	139	4	1,064
Total revenues	1,153	731	152	142	53	2,231
Production (lifting) costs	460	256	22	62	23	823
Exploration expenses	318	48	26	44	20	456
Depreciation, depletion, amortization and retirements	515	63	77	91	11	757
	(140)	364	27	(55)	(1)	195
Provision for income taxes	(72)	279	11	53	—	271
Results of operations for producing activities	$ (68)	85	16	(108)	(1)	(76)

- Sales exclude revenues received from operation of U.S. natural gas liquids extraction plants and related gas sytems. Transfers are valued at prices which approximate market.
- Production (lifting) costs consist of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. Also included is the U.S. crude oil excise tax of $13 million in 1986; expenses of $150 and $32 million in 1987 and 1986, respectively, to elevate six platforms offshore Norway; and expenses of $41 million in 1988 to construct a concrete wave barrier to protect a facility offshore Norway. It does not include depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.
- Exploration expenses include dry hole, leasehold impairment, geological and geophysical expenses and the cost of retaining undeveloped leaseholds.
- The provision for income taxes is computed by adjusting each country's income before income taxes for permanent differences related to the oil and gas producing activities that are reflected in the company's consolidated income tax expense for the period and then multiplying the result by the country's statutory tax rate.
- Results of operations should not be equated to net income since no deduction has been made for such costs and expenses as distribution, selling, administrative and interest.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities

	Millions of Dollars					
	United States	Norway	United Kingdom	Africa	Other Areas	Total
1988						
Future cash inflows	**$10,217**	**9,572**	**1,260**	**1,174**	**833**	**23,056**
Less:						
Future production costs	**3,877**	**3,171**	**173**	**152**	**395**	**7,768**
Future development costs	**944**	**451**	**113**	**88**	**181**	**1,777**
Future income tax provisions	**1,259**	**4,254**	**499**	**737**	**—**	**6,749**
Future net cash flows	**4,137**	**1,696**	**475**	**197**	**257**	**6,762**
10% annual discount	**1,795**	**810**	**139**	**87**	**144**	**2,975**
Discounted future net cash flows	**$ 2,342**	**886**	**336**	**110**	**113**	**3,787**
1987						
Future cash inflows	$ 9,964	8,599	1,031	1,401	851	21,846
Less:						
Future production costs	4,166	3,342	164	210	394	8,276
Future development costs	1,020	386	107	97	213	1,823
Future income tax provisions	1,129	3,466	350	870	—	5,815
Future net cash flows	3,649	1,405	410	224	244	5,932
10% annual discount	1,700	721	124	91	155	2,791
Discounted future net cash flows	$ 1,949	684	286	133	89	3,141
1986						
Future cash inflows	$ 9,137	9,634	969	1,437	778	21,955
Less:						
Future production costs	3,136	3,446	263	252	272	7,369
Future development costs	996	412	137	62	177	1,784
Future income tax provisions	1,255	4,371	265	960	53	6,904
Future net cash flows	3,750	1,405	304	163	276	5,898
10% annual discount	1,707	680	73	75	169	2,704
Discounted future net cash flows	$ 2,043	725	231	88	107	3,194

- Future net cash flows is computed using year-end prices and costs and appropriate statutory tax rates that relate to existing proved oil and gas reserves in which the company has mineral interests.

Sources of change in the standardized measure of discounted future net cash flows are as follows:

	Millions of Dollars		
	1988	1987	1986
Revenues less production costs for the year	**$(1,318)**	(1,268)	(1,408)
Net change in prices and production costs for the year	**382**	(574)	(5,313)
Extensions, discoveries and improved recovery less estimated future costs	**478**	217	1,019
Development costs for the year	**298**	259	280
Sales of reserves in place less estimated future costs	**(44)**	(4)	(972)
Revisions of previous quantity estimates and other	**939**	114	156
Accretion of discount	**569**	629	1,188
Net change in income taxes	**(658)**	574	3,521
	$ 646	(53)	(1,529)

- The net change in prices and production costs is the beginning of the year reserve production forecast multiplied by the net annual change in the per unit sales price and production cost, discounted at 10 percent.
- Purchases and sales of reserves in place, and extensions, discoveries and improved recovery are production forecasts of the applicable reserve quantities for the year multiplied by the end of the year sales price, less future estimated development and production costs, discounted at 10 percent.
- The accretion of discount is 10 percent of the prior year's discounted future cash inflows less future production and development costs.
- The net change in income taxes is the annual change in the discounted future income tax provisions.

	Millions of Dollars Except as Indicated				
	1988	1987	1986	1985	1984
Selected Income Data					
Sales and other operating revenues	**$11,304**	10,721	9,788	15,676	15,537
Net income	**650**	35	228	418	810
Selected Balance Sheet Data					
Current assets	**3,062**	2,885	2,802	3,150	4,611
Properties, plants and equipment (net)	**8,417**	8,772	9,186	10,365	11,773
Total assets	**11,968**	12,111	12,403	14,052	16,965
Current liabilities	**2,468**	2,402	2,234	3,114	5,352
Long-term debt	**4,761**	5,419	5,758	6,548	2,840
Deferred income taxes	**1,874**	1,705	1,685	1,673	1,433
Redeemable preferred stock	**—**	205	270	281	—
Common stockholders' equity	**2,113**	1,617	1,724	1,644	6,624
Selected Statement of Cash Flows Data					
Net cash provided by operating activities	**1,865**	1,162	1,305	1,865	1,802
Capital expenditures					
Exploration and Production	**377**	391	339	662	733
Gas and Gas Liquids	**37**	43	86	133	326
Petroleum Products	**177**	131	75	94	105
Chemicals	**130**	78	46	44	77
Corporate and Other	**76**	94	100	132	123
Total	**797**	737	646	1,065	1,364
Dividends paid					
Common	**157**	137	159	542	362
Preferred	**11**	19	24	12	—
Other Data					
Net income					
As percent of total revenues	**5.7%**	.3	2.3	2.6	5.1
As percent of average total assets	**5.4%**	.3	1.7	2.7	6.0
As percent of average common stockholders' equity	**35.8%**	2.1	13.5	14.7	12.7
Percent of long-term debt to capital	**69.3%**	74.8	74.3	77.3	30.0
Current ratio	**1.2**	1.2	1.3	1.0	.9
Per average common share outstanding					
Net income	**$ 2.72**	.06	.89	1.44	1.75
Cash dividends declared	**$ .66**	.60	.70	.95	.78
Common stockholders' equity per share	**$ 8.69**	7.08	7.55	7.24	14.28
Market price per common share					
High	**$ 22.38**	18.75	12.75	17.17	18.75
Low	**$ 12.13**	10.00	8.25	11.00	11.13
Close	**$ 19.50**	14.00	11.75	12.13	14.92
Common shares outstanding at year-end (in millions)	**243.3**	228.4	228.3	227.1	463.9
Common stockholders at year-end (in thousands)	**96.9**	100.1	109.0	83.3	113.4
Gross payroll including employee benefits	**$ 1,053**	998	974	1,130	1,164
Employees at year-end (in thousands)	**21.0**	22.5	21.8	25.3	29.3

FIVE-YEAR OPERATING REVIEW

Exploration and Production	1988	1987	1986	1985	1984
	Thousands of Barrels Daily				
Net Crude Oil Production					
United States	**110**	113	124	154	136
Norway	**57**	46	52	63	72
United Kingdom	**19**	22	23	24	24
Africa	**25**	25	29	32	28
Canada	**5**	5	4	4	4
Southeast Asia	**2**	2	1	—	3
Latin America	**4**	5	5	4	1
	222	218	238	281	268
Net Natural Gas Liquids Production					
Norway	**12**	8	10	12	12
Gas and Gas Liquids*	**174**	174	192	192	180
	186	182	202	204	192

**Total natural gas liquids plant production—see Gas and Gas Liquids in next column for details.*

Net Natural Gas Production—Wet Basis	1988	1987	1986	1985	1984
	Millions of Cubic Feet Daily				
United States	**851**	772	820	876	843
Norway*	**259**	241	217	327	364
United Kingdom*	**47**	43	54	55	58
Canada	**32**	30	29	31	19
Other Europe	**—**	—	—	17	4
	1,189	1,086	1,120	1,306	1,288

**Dry basis.*

Net Oil and Gas Acreage	1988	1987	1986	1985	1984
	Millions of Acres				
United States	**5**	5	6	7	9
Europe	**1**	2	1	1	2
Africa	**8**	8	2	1	2
Canada	**1**	1	3	4	4
Asia	**5**	1	1	2	6
Latin America	**—**	—	—	—	1
	20	17	13	15	24

Oil and Gas Wells	1988	1987	1986	1985	1984
	Net Wells				
United States					
Oil	**7,292**	7,424	7,861	9,077	9,207
Gas and condensate	**2,721**	2,715	2,749	2,805	2,744
Outside United States					
All wells	**572**	552	576	542	561
	10,585	10,691	11,186	12,424	12,512

Well Completions	1988	1987	1986	1985	1984
United States					
Exploratory	**19**	31	32	59	72
Development	**150**	128	92	226	269
Outside United States					
Exploratory	**18**	14	7	5	5
Development	**23**	5	8	8	27
	210	178	139	298	373

Gas and Gas Liquids (United States)	1988	1987	1986	1985	1984
	Millions of Cubic Feet Daily				
Natural Gas Purchases					
Outside Phillips	**1,542**	1,602	1,531	1,542	1,367
Phillips	**377**	357	395	378	396
	1,919	1,959	1,926	1,920	1,763
Natural Gas Processed	**1,859**	1,910	2,041	2,160	1,858
Natural Gas Sales					
Residue gas					
Outside Phillips	**1,034**	1,044	1,009	1,044	895
Phillips	**138**	142	158	146	188
	1,172	1,186	1,167	1,190	1,083
Liquefied natural gas	**99**	93	96	101	101
	1,271	1,279	1,263	1,291	1,184

Net Natural Gas Liquids Plant Production*	1988	1987	1986	1985	1984
	Thousands of Barrels Daily				
From leasehold gas	**30**	29	36	31	33
From purchased gas	**144**	145	156	161	147
	174	174	192	192	180

**See Exploration and Production in previous column for total company production.*

Petroleum Products

Refinery Operations	1988	1987	1986	1985	1984
Crude oil capacity	**305**	305	300	300	295
Crude oil runs	**301**	302	301	292	288
Natural gas liquids processing capacity	**227**	223	223	223	218
Natural gas liquids processed	**200**	195	201	195	193
Petroleum Products Sold					
United States					
Automotive gasoline	**275**	256	243	239	218
Aviation fuels	**36**	32	31	31	26
Distillates	**100**	98	93	91	82
Liquefied petroleum gas	**95**	90	99	108	95
Other products	**34**	37	47	59	35
	540	513	513	528	456
Outside United States	**45**	42	41	47	51
	585	555	554	575	507
Marketing Outlets (in thousands)	**11**	12	12	12	11

Chemicals

Selected Outside Sales	1988	1987	1986	1985	1984
	Millions of Pounds				
Ethylene	**720**	903	803	812	481
Polyethylene	**1,585**	1,606	1,410	1,508	1,358
Propylene	**131**	120	64	76	68
Polypropylene	**397**	238	205	175	190

BOARD OF DIRECTORS & PRINCIPAL OFFICERS

As of March 1, 1989

Directors

Norman R. Augustine, 53, chairman and chief executive officer, Martin Marietta Corporation. Previously at Martin Marietta Corporation, vice chairman and chief executive officer, president and chief operating officer, executive vice president and senior vice president. Lives in Potomac, Md. Elected to Phillips board 1989. (3), (5)

George B. Beitzel, 60, retired senior vice president and director, International Business Machines Corporation. Lives in Chappaqua, N.Y. Elected to Phillips board 1980. Also a director of Bankers Trust New York Corporation and its subsidiary, Bankers Trust Company; FlightSafety International, Inc.; Rohm and Haas Company; Roadway Services, Inc.; Square D Company; and a member of the advisory board of International Business Machines. (1), (3), (4)

Glenn A. Cox, 59, president and chief operating officer since 1985. Previously, executive vice president (1980); vice president, management information and control (1974). Joined Phillips 1956; elected to board 1982. Also a director of BancOklahoma Corp. (1)

James B. Edwards, 61, president, Medical University of South Carolina; former U.S. secretary of energy and governor of South Carolina. Lives in Mount Pleasant, S.C. Elected to Phillips board 1983. Also a director of The South Carolina National Corporation and its subsidiary, The South Carolina National Bank; Brendle's, Inc.; SCANA Corporation; Chemical Waste Management, Inc.; Imo Delaval Inc.; and Encyclopaedia Britannica, Inc. (1), (2), (3)

Robert F. Froehlke, 66, president and chief executive officer and director, IDS Mutual Fund Group; former chairman of the board of directors, The Equitable Life Assurance Society of the United States. Lives in Minneapolis, Minn. Elected to Phillips board 1984. Also a director of Square D Company and the Public Oversight Board of the American Institute of Certified Public Accountants. Also chairman of the Institute for Defense Analysis. (2), (5)

E. Douglas Kenna, 64, partner, G.L. Ohrstrom & Company, a private investment group. Lives in N. Palm Beach, Fla. Elected to Phillips board 1977. Also a director of Burnley Corporation, Carlisle Corporation and Fleet/Norstar Financial Group. (1), (2), (4)

Melvin R. Laird, 66, senior counsellor for national and international affairs, The Reader's Digest Association, Inc.; former nine-term U.S. congressman, secretary of defense and presidential counsellor. Lives in Bethesda, Md. Elected to Phillips board 1976. Also a director of Northwest Airlines, Inc.; Metropolitan Life Insurance Company; Science Applications International Corporation; Communications Satellite Corporation; Martin Marietta Corporation; IDS Mutual Fund Group; and the Public Oversight Board of the American Institute of Certified Public Accountants. (4), (5)

L. M. Rickards, 61, executive vice president, responsible for company's upstream businesses, since 1985. Previously, senior vice president, exploration and production (1980); vice president, North America exploration and production (1977). Joined Phillips 1950; elected to board 1987.

C. J. Silas, 56, chairman of the board of directors and chief executive officer since 1985. Previously, president and chief operating officer (1982); executive vice president (1980); senior vice president, natural resources (1978); vice president, gas and gas liquids (1976). Joined Phillips 1953; elected to board 1982. Also a director of The First National Bank and Trust Company of Tulsa. (1)

B. M. Thompson, 56, executive vice president, responsible for Phillips downstream businesses, since 1988. Previously, senior vice president, planning and technology (1986); vice president, corporate planning and development (1983). Joined Phillips 1954; elected to board 1988.

W. Clarke Wescoe, 68, retired chairman of the board of directors, Sterling Drug Inc., a diversified pharmaceutical company; former chancellor, University of Kansas. Lives in Minneapolis, Minn. Elected to Phillips board 1963. Also a director of The New York Stock Exchange. (2), (3)

Dolores D. Wharton, 61, president, The Fund for Corporate Initiatives, Inc., a nonprofit organization devoted to strengthening the role of minorities and women in the corporate world. Lives in New York, N.Y. Elected to Phillips board 1976. Also a director of Gannett Co., Inc.; Kellogg Company; and Golub Corporation. (3), (5)

Francis M. Wheat, 68, advisory partner, and former senior partner, law firm of Gibson, Dunn & Crutcher. Lives in Los Angeles, Calif. Elected to Phillips board 1976. (2), (5)

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(1) Member Executive Committee
(2) Member Audit Committee
(3) Member Compensation Committee
(4) Member Nominating Committee
(5) Member Public Policy Committee

Officers

C. J. Silas, Chairman of the Board of Directors and Chief Executive Officer
Glenn A. Cox, President and Chief Operating Officer
L. M. Rickards, Executive Vice President
B. M. Thompson, Executive Vice President
R. E. Bonnell, Senior Vice President Finance
C. L. Bowerman, Senior Vice President Petroleum Products
William G. Paul, Senior Vice President and General Counsel
K. L. Smalley, Senior Vice President
D. J. Tippeconnic, Senior Vice President

Other Corporate Officers

W. W. Allen, Vice President International Exploration and Production
C. F. Cook, Vice President Research and Development
L. L. Frantz, Vice President Human Resources and Services
J. C. Mihm, Vice President Corporate Engineering
J. J. Mulva, Vice President and Treasurer
J. W. O'Toole, Vice President and General Tax Officer
Richard I. Robinson, Vice President Refining
Ray G. Steiner, Vice President Supply and Transportation
J. R. VanBuskirk, Vice President Plastics
J. Whitmire, Vice President North America Exploration and Production
J. Bryan Whitworth, Vice President Corporate Affairs
C. L. Wyndham, Vice President Exploration
James A. Kelly, Comptroller
L. E. Burnham, General Auditor
G. C. Meese, Secretary
L. F. Francis, Assistant General Tax Officer
J. M. McKee, Assistant Treasurer
D. L. Cone, Assistant Secretary
Terry B. Nance, Assistant Secretary

MANAGEMENT & BOARD OF DIRECTORS CHANGES

The following changes regarding Phillips board of directors occurred in 1988 and early 1989:

- David B. Meeker, director since 1976, died January 22, 1989, at age 63. He was former chairman of the board of directors of Hobart Corporation.
- Norman R. Augustine, chairman of the board of directors and chief executive officer of Martin Marietta Corporation, was elected to Phillips board January 9, 1989.
- R. G. Wallace, executive vice president and director, retired November 1, 1988, having concluded 34 years' service.
- Carol C. Laise retired from the board of directors April 26, 1988, having reached mandatory retirement age.
- B. M. Thompson, executive vice president, was elected to the board of directors, April 26, 1988.

The following management changes took place in 1988:

- B. M. Thompson, formerly senior vice president planning and technology, was named executive vice president, with responsibility for downstream operations.
- C. L. Bowerman, formerly vice president marketing and petroleum products, was named senior vice president petroleum products.
- D. J. Tippeconnic, formerly vice president human resources and services, was named senior vice president, with responsibility for planning and technology.
- L. L. Frantz, formerly manager of the Permian Basin region in exploration and production, was named vice president human resources and services.
- J. C. Mihm, formerly manager corporate engineering, was named vice president corporate engineering.
- J. J. Mulva, formerly treasurer, was named vice president and treasurer.

STOCKHOLDER INFORMATION

Annual Meeting
Phillips annual meeting of stockholders will be held at 10:00 a.m., April 25, 1989, in the Adams Building, 4th St. & Keeler Ave., Bartlesville, Okla. Notice of the meeting and proxy material are being sent to all stockholders.

Information Requests
The company welcomes your comments about its operations or any aspect of its business. Write to one of the addresses below, or contact Phillips investor relations office in New York City (212/397-9766) or Bartlesville (918/661-5126).

Questions about stockholder records, stock certificates, dividends or the dividend reinvestment plan should be directed to the stockholder records section in Bartlesville. Please write to the company's Bartlesville address in care of Stockholder Records, or call toll-free, 1-800-356-0066 (in Oklahoma, 1-800-722-0660).

Dividend Reinvestment Plan
Phillips dividend reinvestment plan enables shareholders to buy additional shares with their common stock dividends. Participants also may make commission-free purchases of company stock through direct cash payment. Contact Stockholder Records in Bartlesville for details.

Form 10-K
Copies of the Phillips Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, are available without charge by writing to the Office of the Secretary at the Bartlesville address below.

Annual Contributions Report
Copies of the company's annual contributions report are also available without charge by writing to the Office of the Secretary.

Principal Offices
Bartlesville, Okla. 74004

630 Fifth Avenue
New York, N.Y. 10111

306 S. State Street
Dover, Del. 19901

Stock Transfer Offices
Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

Montreal Trust Company
15 King Street West
Toronto, Ontario
Canada M5H 1B4

Registrars
Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

Montreal Trust Company
66 Temperance Street
Toronto, Ontario
Canada M5H 1Y7

BOARD OF DIRECTORS

Norman R. Augustine
George B. Beitzel

Glenn A. Cox
James B. Edwards
Robert F. Froehlke

E. Douglas Kenna
Melvin R. Laird
L. M. Rickards

C. J. Silas
B. M. Thompson
W. Clarke Wescoe

Dolores D. Wharton
Francis M. Wheat

PHILLIPS PETROLEUM COMPANY
BARTLESVILLE, OKLAHOMA 74004

Bulk Rate
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Phillips Petroleum
Company